of service. Board members believed the attribution period should include all employee service periods for which a nontrivial incremental postretirement benefit is earned. The Board recognized that consideration of those measurement assumptions in determining the full eligibility date would be inconsistent with how Statement 87 applies to certain pension plans with maximum credited service periods. Those situations are limited.

223. The Board concluded that it is willing to accept that inconsistency because considering all years of service that provide an incremental benefit in determining an employee's full eligibility date is both more understandable and more consistent with the accounting for other deferred compensation contracts under Opinion 12. Consequently, the full eligibility date is determined by plan terms that provide incremental benefits for additional service, such as benefits based on final pay or benefits that are indexed through an employee's active service period, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by plan terms that define when benefit payments commence or by an employee's current dependency status. (Paragraphs 397-408 illustrate determination of the full eligibility date.)

224. Respondents to the Exposure Draft generally disagreed with ending the attribution period at an employee's full eligibility date. Those respondents supported attributing benefits to an employee's full service period—ending with the expected retirement date—whether or not the benefit formula defines the specific years of service to be rendered in exchange for the benefits. Many respondents indicated that, irrespective of the terms of the plan, attributing benefits to employees' full service periods reflects the employer's intent, asserting that the postretirement benefits promised to employees are substantially independent of their compensation levels or years of service. Other respondents indicated that attributing postretirement benefits to an employee's expected retirement date is more consistent with the attribution period for most pension benefits.

225. In its redeliberation of the attribution period, the Board observed the results of the field test of the Exposure Draft. Those results suggested that, for many employers who elect delayed recognition of the transition obligation, the difference in net periodic cost that results from attributing the expected postretirement benefit obligation to an employee's full eligibility date rather than the employee's expected retirement date is minimal. That is because, in those situations, net periodic cost reflects the interplay of service cost, interest cost, and amortization of an employer's transition obligation. If the expected postretirement benefit obligation is attributed to an employee's full eligibility date, the transition obligation that is recognized on a delayed basis in future periods is greater than if the benefit obligation is attributed over a longer period. In addition, if the benefit obligation is attributed to an employee's full eligibility date, there is no service cost for fully eligible plan participants. As a result of those effects, and the relative magnitude of interest cost, regardless of the attribution period, the net periodic cost for most employers is not likely to be significantly affected by attributing the expected postretirement benefit obligation over service to employees' full eligibility dates rather than over service to employees' expected retirement dates.

226. The Board observes that the terms of most pension plans result in attributing the pension benefits to the years of service to an employee's expected retirement date. Because most pension plans provide an incremental benefit for each year of service, the full eligibility date and retirement date are the same. Recent surveys suggest a trend among employers to amend their postretirement benefit plans to define the amount of benefits employees will receive based on the length of their service, similar to most pension plans. If that trend continues, the full eligibility date for many or most postretirement benefit plans also may be the employee's retirement date.

227. For postretirement benefit plans that are not pay-related or otherwise indexed during an employee's service period (most existing postretirement health care plans), attributing the benefits to an employee's full eligibility date is consistent with the attribution period for pension benefits; what may make the periods appear to be different is different plan terms that define when the benefits are earned. For postretirement benefit plans that are pay-related or that otherwise index benefits during employees' service periods to their retirement date, the full eligibility date and retirement date generally will be the same. The attribution period for those benefits will differ from the attribution period for a similarly defined pension benefit with a capped credited service period. (Refer to discussion in paragraphs 222 and 223.)

228. Ending the attribution period at an employee's full eligibility date is consistent with the plan terms, which, in the Board's view, provide the best evidence of the exchange transaction. The accounting for an exchange transaction should reflect the understanding of both parties to the transaction. If an employer were to change the eligibility requirements for postretirement benefits from 10 years of service and attainment of age 55 while in service to a requirement of 15 years of service and attainment of age 62 while in service, that would be a fundamentally different promise with an economic consequence for the employer and at least some employees. The Board believes it would not be representationally faithful to ignore the difference between those promises in determining the attribution period.

229. The Board considered attributing benefits beyond the full eligibility date in some, but not all, cases. Several criteria were considered in defining the conditions under which that should occur, such as whether eligibility for benefits is attained gradually or all at once, whether the benefit formula unambiguously defines the specific years of service to be rendered, whether a specific age must be attained while in service, and whether retirement from the company is required.

230. The Board considered an approach that would require attribution of benefits beyond a plan participant's full eligibility date to the participant's expected retirement date if all eligible plan participants receive the same benefit and if eligibility for the benefits is attained all at once upon attaining a specified age while in service, upon rendering a specified number of years of service, or a combination of both. However, the Board rejected that approach because it was troubled by the arbitrary nature of the resulting attribution period. For example, if a plan provides 60 percent of the cost of postretirement health care benefit coverage to all employees who render 25 or more years of service, that approach would require attribution over a 30-year period for an

employee expected to retire after 30 years of service. However, if a plan provides 40 percent of the cost of postretirement health care benefit coverage to all employees who render 20 years of service and an additional benefit of 4 percent for service in each of the following 5 years, the expected postretirement benefit obligation for an employee expected to render 30 years of service would be attributed to that employee's first 25 years of service. The accounting would attribute the benefits over different periods even though, in both cases, the benefit promise would be vested after 25 years of service and service beyond 25 years would not result in an incremental benefit.

231. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date for those benefits if a plan's benefit formula does not unambiguously define the specific period of service to be rendered in exchange for the benefits. The Board rejected that condition because of the inconsistent results that would occur. For example, if one plan provides 75 percent of the cost of postretirement health care coverage to employees who render 30 years of service and a different plan provides the same benefits to employees who attain age 55 while in service and render at least 10 years of service, benefits would be attributed beyond the full eligibility date in the latter case but not the former. For an employee hired at age 25 who is expected to render 40 years of service, the benefits under the first plan would be attributed to the employee's first 30 years of service and the benefits under the second plan would be attributed to the employee's full service period, even though the same benefit is earned upon meeting the age and service conditions of the respective plans.

232. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date if a plan's benefit formula requires attaining a specified age while in service. In that case, the credited service period is not unambiguously defined. The Board noted that the approach creates anomalies and rejected it as arbitrary for the reasons discussed in paragraphs 230 and 231.

233. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date if an employee must meet the employer's criteria for retirement before termination in order to receive the benefits. [36] Under that approach, the benefit promise is viewed as an exchange for service over an employee's career, and retirement is viewed as the recognizable event. The Board rejected that approach for several reasons. While meeting the employer's criteria for retirement may define when postretirement benefit coverage is expected to commence, the act of retirement in and of itself does not reflect the exchange that takes place between the employer and an employee. It is the required employee service that is exchanged for postretirement benefits. In addition, an approach that attributes benefits beyond the full eligibility date based on the act of retirement would be inconsistent with accruing other deferred compensation contracts, including pensions, to the full eligibility date.

234. The need to be "retired" in order to receive benefits is not unique to other postretirement benefit plans. At the full eligibility date the employee has completed the contractual requirements for eligibility for all the postretirement benefits that employee is expected to

receive and can terminate with entitlement to those benefits when a specified event occurs or the need for those benefits arises. An objective of accounting for deferred compensation contracts is to measure the accrued liability defined by the contract as reliably as possible and, therefore, to recognize cost over the periods in which the benefits are earned and the exchange takes place. Although for some contracts it may not be possible to determine the portion of the expected future benefits earned by an employee before that employee attains full eligibility for the benefits, no uncertainty remains at the full eligibility date. The total expected postretirement benefits have been earned at that date.

235. Attribution of postretirement benefits beyond the date full eligibility for the benefits is attained would suggest that there is a difference between "fully vested" pension benefits and "full eligibility" for other postretirement benefits. At the full eligibility date, the *right* to the benefits is not contingent upon rendering future service. Both vesting in pension benefits and attaining full eligibility for postretirement benefits are rights that are "earned" (exchanged) for meeting specified age, service, or age and service requirements. In both cases, an employee is not entitled to *receive* the benefits until after the employer-employee relationship is terminated. The Board saw no significant distinction between the two.

236. Paragraph 42(a) of Statement 87 states that "for benefits of a type includable in vested benefits,[9] [the benefits shall be considered to accumulate] in proportion to the ratio of the number of completed years of service to the number that will have been completed *when the benefit is first fully vested*" (emphasis added). Footnote 9 of Statement 87 describes a supplemental early retirement benefit that is vested after a stated number of years as an example of a benefit of a type includable in vested benefits. Paragraph 42(b) of Statement 87 states that "for benefits of a type not includable in vested benefits, [10] [the benefits shall be considered to accumulate] in proportion to the ratio of completed years of service to total projected years of service." Footnote 10 of Statement 87 describes a death or disability benefit that is payable only if death or disability occurs during active service as an example of a benefit of a type *not* includable in vested benefits. Most postretirement benefits are of a type includable in vested benefits.

237. The Board was unable to identify any approach that would, in its opinion, appropriately attribute benefits beyond the date full eligibility for those benefits is attained. Accordingly, the Board concluded that postretirement benefits should not be attributed to service beyond the date an employee attains full eligibility for those benefits. The Board also concluded that if the benefit formula defines the beginning of the credited service period, benefits generally should be attributed from that date. If the beginning of the credited service period is not defined, the beginning of the credited service period is deemed to be the date of hire, and benefits should be attributed from that date.

238. Some Board members disagree with ending the attribution period at the full eligibility date as defined in this Statement. They support attributing the expected postretirement benefit obligation from an employee's date of hire (or beginning of the credited service period, if later)

to the date beyond which the employee's additional service will not change (neither increase nor decrease) the amount of benefits to which the employee will be entitled— usually the employee's retirement date. That approach would extend the attribution period to include any years of employee service during which the employer conceptually incurs a negative service cost because the employee, by electing to continue service after earning a vested postretirement benefit, gives back benefits that have been earned (refer to paragraphs 240-242). This Statement attributes the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, to years of credited service and assigns no service cost to the years of service beyond the full eligibility date. Those Board members would attribute the expected postretirement benefit obligation on a pro rata basis to *all* years of service that change the amount of benefits an employee is entitled to receive, *including* those years in the giveback period.

239. Those Board members recognize that, depending on a plan's terms, an employee's full eligibility date may be the same as the employee's retirement date. In those instances there is no period during which the employer conceptually incurs a negative service cost. But for many existing plans, an employee's full eligibility date and retirement date differ. Those Board members are concerned with those latter plans. They observe that many existing plans provide benefits to employees "upon retirement" or "upon retiring from the company" without defining the specific years of service to be rendered in exchange for the benefits. Those Board members believe that, for those plans, ending the attribution period at the expected retirement date more appropriately reflects the understanding that postretirement benefits are exchanged for *all* years of employee service. Those Board members believe that attributing benefits to the date beyond which an employee's service will not change the amount of benefits to be received by the employee is a preferable, practical, and understandable approach to attributing the expected postretirement benefit obligation to years of service.

Amount attributed

240. Implicit in the Board's conclusion is the view that at the full eligibility date the employer has a measurable obligation to provide benefits in the future. The Board considered whether measurement of that obligation for a plan that provides benefits immediately after retirement should be based on (a) benefits the employee is expected to receive given the employee's expected retirement date (the expected postretirement benefit obligation) or (b) benefits the employee would be eligible to receive were the employee to retire (terminate) immediately (a vested postretirement benefit obligation). Under the latter approach, if the vested postretirement benefit obligation for an employee were attributed to service to the full eligibility date and that employee continued to render service rather than retire, a negative service cost would be recognized (for the reduction in the vested postretirement benefit obligation) during the subsequent service period as the employee foregoes a portion of the benefits that had been earned at the full eligibility date. Under either approach the same obligation—the expected postretirement benefit obligation—would be recognized at the employee's retirement date.

241. Attributing the vested postretirement benefit obligation to service to the full eligibility

date is viewed as conceptually appropriate by some Board members. At that date, an obligation exists to provide postretirement benefits; that obligation is no longer contingent upon the employee rendering future service. Those Board members believe it is inconsistent to measure an obligation to which an employee is immediately eligible as the expected postretirement benefit obligation, which considers that benefits commence after additional future service, because no future service is required. They believe that a measurement based on rendering future service is not representationally faithful when a greater benefit has been earned that is not dependent upon the rendering of future service.

242. The ability to satisfy the benefit obligation at less than the "vested" amount is outside the control of an employer. Further, to attribute benefits on the basis of the expected postretirement benefit obligation anticipates an employee's election to remain in service and consequently give back a benefit. Certain Board members believe that, conceptually, that election should be accounted for as it is made. In their view, recognition of the vested postretirement benefit obligation at the full eligibility date and the subsequent giveback of benefits in the intervening period until retirement better reflects the exchange that has occurred. That is, the employer has promised to provide a specified level of benefit coverage in exchange for a minimum period of employee service or service to a specified attained age. During the service period subsequent to the full eligibility date, the economic benefit to the employee for continuing to work (and the employer's compensation cost) is the excess of the amount the employee receives for working over the amount the employee would have received had the employee not continued to work.

243. Despite the conceptual support that some Board members believe exists for attributing the vested postretirement benefit obligation over the service period to the full eligibility date, Board members recognized the difficulty of conveying to preparers and users of financial statements the notion of a negative service cost for some employees. Therefore, the Board concluded that the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, should be attributed to service to the full eligibility date.

244. The Board acknowledges that attribution of the expected postretirement benefit obligation to the full eligibility date may be viewed as being internally inconsistent because recognition and measurement are on different bases. Whereas recognition is based on service to the full eligibility date, measurement of the obligation considers service beyond that date because an employer must consider when benefit payments are likely to commence in order to measure the expected postretirement benefit obligation that is to be attributed to employees' service periods. The Board notes that although some future events do not provide a basis for recognition of elements of financial statements, they may affect the measurement of recognized past events. The Board concluded that, absent a reconsideration of fundamental measurement and recognition concepts, attribution of the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, to the full eligibility date is preferable given the evolutionary state of accounting for postretirement benefits.

Attribution pattern

245. The Exposure Draft proposed attributing the expected postretirement benefit obligation to employee service using the benefit formula. That is, if the benefit formula attributes certain benefits to individual years or groups of years of service in the credited service period, the benefit formula generally would have been followed for attribution purposes. Otherwise, an equal amount of the expected benefits would have been assigned to each year of service in the attribution period. The Board believed then and continues to believe that the benefit formula is the most relevant basis for attributing benefits to years of service. However, it is particularly difficult to attribute benefits to years of service in accordance with the present terms of many postretirement health care plans. Frequently, the plan terms are ambiguous and quite difficult to apply at interim dates. For example, a plan may define different benefits for different years of service and have a separate age and service requirement that must be met to attain eligibility for any benefits.

246. Following a plan's benefit formula for attributing postretirement benefits to individual years of service in the attribution period adds a degree of complexity that the Board concluded was unnecessary. The Board believes that the primary objective of attribution is to have fully accrued the actuarial present value of the cost of the postretirement benefits expected to be provided to an employee pursuant to the terms of the contract (the expected postretirement benefit obligation) at the date the employee attains full eligibility for those benefits. Although following the benefit formula for attribution purposes would be more representationally faithful and consistent with Statement 87, the Board concluded that because postretirement benefits do not typically vest at interim dates during an employee's service period in the same manner as pension benefits, and because the terms of postretirement benefit plans generally are more complex than the terms of pension plans, the obligation accrued at an interim date is not as relevant and reliable as the obligation accrued at the full eligibility date. Consequently, in order to reduce complexity, the Board concluded that the expected postretirement benefit obligation should be recognized by assigning an equal amount to each year of service in the attribution period, unless the plan's benefit formula attributes a disproportionate share of the expected postretirement benefit obligation to employees' early years of service.

Transition

247. The issues of how and when the transition amount should be recognized are sensitive ones to employers who face, for the first time, the prospect of accruing the cost of postretirement benefits exchanged for current service as well as accounting for the cost of those benefits exchanged for prior service. Unlike the effects of most other accounting changes, a transition obligation for postretirement benefits generally reflects, to some extent, the failure to accrue the obligation in the earlier periods in which it arose rather than the effects of a change from one accrual method of accounting to another.

248. An employer changing from the cash basis of accounting for postretirement benefits to the

accrual basis required by this Statement has not recognized any of the cost of the benefits for active plan participants and only some portion of the cost of the benefits for retired plan participants—amounts that would have been recognized as the service and interest cost components of net periodic postretirement benefit cost in earlier periods. In addition, an indeterminate portion of the transition obligation may represent unrecognized prior service cost arising from a plan initiation or amendment, an unrecognized net gain or loss, or an unrecognized obligation from a prior business combination.

249. Determining the portion of the transition obligation that represents unrecognized service cost and interest cost of prior periods would require retroactively measuring the amount of benefit obligation that would have been recognized for each prior period by the employer had this Statement always been applied. To do that, an employer would have to determine the historical data and assumptions about the economic environment that would have been made at the date of plan adoption and at each subsequent measurement date. It is unlikely that the data necessary to measure the obligation at those dates exist, and it would be difficult, if not impossible, to develop assumptions that ignore the benefit of hindsight.

250. The Board concluded that transition is, to a significant extent, a practical matter. A major objective of transition is to minimize implementation costs and to mitigate disruption to the extent possible without unduly compromising the ability of financial statements to provide useful information. The Board also concluded that it would be confusing, complex, and inconsistent to measure the transition obligation differently from other measurements in accounting for postretirement benefits. The transition obligation is measured as the unrecognized unfunded accumulated postretirement benefit obligation, which is based on the portion of the expected postretirement benefit obligation attributed to each year of service rendered prior to a plan participant's full eligibility date. That measurement is consistent with the attribution of benefits to years of service, measurement of the effects of a plan initiation that grants retroactive benefits or a plan amendment, and the measurement of a postretirement benefit obligation assumed in a business combination accounted for as a purchase.

251. Changes from cash basis to accrual basis accounting are usually made retroactively. If the components of the transition obligation (asset) could be separately determined, it would be consistent with other provisions of this Statement to treat the unrecognized current service and interest cost as the cumulative effect of an accounting change (that is, to immediately recognize those components when this Statement is first applied), and retroactively remeasure prior purchase business combinations for postretirement benefit obligations assumed but not recognized. It also would be consistent to recognize at least some of the unrecognized prior service cost and unrecognized gain or loss prospectively, based on the delayed recognition afforded those components of postretirement benefit cost by this Statement. However, if the cumulative effect of the accounting change were required to be estimated, the cost of doing so could be prohibitive and the results questionable for the reasons discussed in paragraph 249.

252. Several alternatives to immediate recognition of the transition obligation or asset were

considered. The Board believed that, conceptually, immediate recognition of the cumulative effect of the accounting change (as described in paragraph 251) would be most appropriate. The potential magnitude of the accumulated postretirement benefit obligation, particularly the obligation for postretirement health care benefits, suggests that any omission of that obligation would detract from the usefulness of the statement of financial position. However, the Board recognized that the magnitude of that obligation and the limited availability of historical data on which to base its measurement suggest the need for a more pragmatic approach. Those considerations led the Board to conclude in the Exposure Draft that the initial emphasis of this Statement should be on disclosure of the transition obligation and that the subsequent recognition of that amount in the statement of financial position and in the statement of income should be phased in over future periods.

253. Respondents generally favored a transition period longer than the 15-year period proposed in the Exposure Draft. Some maintained that the magnitude of employers' transition obligations argues for a longer transition period to minimize disruption of current practice. Others noted that a longer transition period would better reflect the average remaining service period of the employee work force that will be entitled to the benefits. Because most existing plans do not give employees postretirement health care benefits unless they meet the company's criteria for retirement with an immediate pension benefit, the remaining service periods of participants in a postretirement health care plan is typically longer than the remaining service periods of participants in a pension plan. Employees who are eligible for postretirement health care benefits are generally only long-service employees, while employees are often entitled to a deferred vested pension benefit if they terminate at younger ages with shorter service periods. For a majority of the companies that participated in the field test of the Exposure Draft, the average remaining service period of the active participants in their postretirement benefit plans was between 18 years and 21 years; previous surveys of employers' pension plans indicated an average remaining service period of those plan participants that is several years shorter.

254. The Board concluded that employers whose plan participants' average remaining years of service is less than 20 years could elect to recognize their transition obligation or asset over 20 years, reflecting the average remaining service periods for participants in many other employers' postretirement benefit plans. However, the Board also concluded that phasing in recognition of a transition obligation should not result in slower recognition of an employer's postretirement benefit obligation than would result from continuation of the pay-as-you-go (cash basis) method. The Exposure Draft proposed that amortization of the transition obligation be accelerated if (a) cumulative benefit payments subsequent to the transition date to fully eligible plan participants at the transition date exceeded the sum of (1) the cumulative amortization of the entire transition obligation and (2) the cumulative interest on the unpaid transition obligation or (b) cumulative benefit payments subsequent to the transition date to all plan participants exceeded the cumulative postretirement benefit cost accrued subsequent to the transition date. As a result of the complexity associated with applying the first of those constraints, the Board concluded that recognition of the transition obligation should be accelerated only if the second constraint applies.

255. Although respondents to the Exposure Draft supported delayed recognition of the transition obligation as a practical approach to transition, most of those respondents also favored permitting (but not requiring) immediate recognition of the transition obligation or asset. They noted that FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits*, permitted immediate recognition of the transition obligation in certain circumstances. They also noted that immediate recognition provides the simplest method of recognition that would most significantly improve financial reporting. Because a significant portion of the transition obligation is likely to relate to service and interest costs for prior periods, they argued that the Board should permit an employer to immediately recognize its transition obligation for postretirement benefits.

256. The Board's consideration of permitting immediate recognition of the transition obligation or asset focused on whether financial reporting would be enhanced by limiting alternatives, recognizing that in doing so, a conceptually defensible, and in some cases preferable, alternative might be eliminated. Some Board members believe that immediate recognition of the transition obligation or asset should not be permitted. They believe that the understandability and comparability of financial reporting, both in the year of adoption and in subsequent periods, would be improved by uniformly phasing in recognition of the transition obligation or asset for postretirement benefits for all employers. They also note that the actuarial techniques for measuring postretirement health care benefit obligations are still developing and should become more sophisticated and reliable with time and experience. They observe that near-term measures of the accumulated postretirement benefit obligation from which the transition obligation is derived will reflect the deficiencies of insufficient data collection in the past and the evolving actuarial practice in this area. They also note that subsequent adjustments to measures of the accumulated postretirement benefit obligation will be recognized in income through the gain or loss component of net periodic postretirement benefit cost.

257. Because an indeterminate portion of the transition obligation may relate to unrecognized prior service cost, an unrecognized net gain or loss, or the effects of a prior purchase business combination, immediate recognition of the transition obligation in its entirety would result in premature recognition of those amounts. Under the recognition provisions of this Statement, those effects are properly recognized in the results of operations for subsequent periods. Some Board members were troubled by that result. This Statement delays recognition of the effects of plan improvements, because they are granted with the expectation that the employer will realize economic benefits in the future, and of plan reductions and permits the delayed recognition of gains and losses. Opinion 16, as amended by this Statement, requires recognition of postretirement benefit obligations assumed in a purchase business combination in determining the cost of the assets acquired, including goodwill related to the purchase; that increase in the cost of the assets acquired is recognized as a charge against operations in future periods.

258. The Board concluded that an employer's transition obligation or asset may be recognized either on a delayed basis or immediately, subject to certain constraints. In reaching that

conclusion, the Board recognized that complete comparability would not be achieved by proscribing immediate recognition of the transition obligation. A few companies have already adopted accrual accounting for postretirement benefits pursuant to Technical Bulletin 87-1 and have immediately recognized their transition obligations. Others would have the opportunity to do so before issuance of this Statement. Despite concerns about the availability and reliability of data on which to base measurement of an employer's accumulated postretirement benefit obligation, the Board believes that the delayed effective date of this Statement should provide for further development of actuarial techniques and the accumulation of more reliable data on which to base the measurements at the date of transition. The Board concluded that employers should not be precluded from recognizing their transition obligations in the manner that some believe most significantly improves financial reporting.

259. The Board considered limiting the immediate recognition of the postretirement benefit transition obligation to the amount in excess of any remaining unrecognized transition asset for pensions because the transition amounts result from similar standards for similar costs. Some Board members are concerned about the credibility of financial statements if income from the transition to one standard is included in income over time, while expense from the transition to a related standard is recognized all at once. Others believe that because the two standards relate to different subjects, credibility is not affected. The Board concluded that immediate recognition of the transition obligation for postretirement benefits should not be limited by any remaining transition asset for pensions. The Board observes that because transition is largely a practical matter, consideration should be given to the facts and circumstances surrounding the issues addressed by the standard. In the case of postretirement benefits other than pensions, some Board members believe that a change from cash basis to accrual accounting is a circumstance sufficiently different from a change from one accrual method to another to justify a unique transition provision. They also believe that the transition obligation for postretirement benefits reflects service cost and interest cost attributable to prior periods to a much greater degree than the transition obligation for pensions.

260. Immediate recognition of an employer's transition obligation or asset is permitted only at the date of initial application of this Statement. The Board concluded that to permit immediate recognition at any subsequent time would result in too much variability in financial reporting for a long period of time. That option also would be inconsistent with some of the arguments in favor of immediate recognition and would introduce additional complexities in determining the amount that could be subsequently recognized.

261. The effect of immediately recognizing a transition obligation or asset and any related tax effect are to be reported separately in the statement of income as the effect of a change in accounting. To more closely approximate the measure of the cumulative effect of the accounting change, the amount immediately recognized in income is required to exclude certain effects that should, more appropriately, be reflected in determining future periods' income. Thus, the amount immediately recognized in income as the effect of the change in accounting is required to exclude the effects of (a) any previously unrecognized postretirement benefit obligation

assumed in a business combination accounted for as a purchase, (b) a plan initiation, and (c) any plan amendment that improved benefits, to the extent that those events occur after the issuance of this Statement.

262. The Board considered excluding from the amount immediately recognized in income any significant portion of the transition obligation attributable to obligations assumed in past purchase business combinations or the effects of past plan initiations or amendments that improved benefits, in order to more reliably measure the effect of the accounting change. However, the Board believes that the data on which those measurements would be based for those past events are generally not available and would be costly, if not impossible, to develop. Some Board members believe that, at a minimum, the amounts related to any of those events that are known or are readily available should be excluded from any transition obligation immediately recognized in income. For primarily practical reasons, the Board concluded that only the constraints identified in paragraph 261 should be applied.

263. The Board considered whether the effects of recognizing an employer's transition obligation or asset should be included in determining net income, as an adjustment of retained earnings, or as a component of comprehensive income, but not net income. Opinion 20 states that most changes in accounting should be recognized by including the cumulative effect of the change in accounting in net income of the period of change. The correction of an error and certain changes in accounting principles identified in that Opinion are recognized by restating prior periods, resulting in an adjustment of beginning retained earnings for the current period.

264. Some respondents favored recognizing the transition obligation (or asset) through a direct charge (or credit) to retained earnings because the amount relates primarily to past periods. However, recognition of the cumulative effect of an accounting change through income, as specified in Opinion 20, is a well-established principle. In addition, implementation issues would arise in recognizing the future effects of changes in the measure of the accumulated benefit obligation that is included in the transition obligation. One such issue would be how the effects of plan amendments that reduce benefits that existed at the transition date or the effects of settlements or curtailments and gains from experience different from that assumed should be reflected.

265. A few respondents supported a comprehensive income approach. Concepts Statement 5 discusses comprehensive income as a broad measure of the effects of all changes in an enterprise's equity for a period, other than from transactions resulting from investments by or distributions to owners. Earnings are described as a measure of performance for a period. Following a comprehensive income approach would include the effects of changes in accounting principles in comprehensive income but not in earnings. Respondents suggested establishing a separate, permanent component of equity to report the effect of recognizing the transition obligation either immediately or on a delayed basis. The suggested approach differs from certain existing separate components of equity (as described in FASB Statements No. 12, *Accounting for Marketable Securities,* and No. 52, *Foreign Currency Translation,* and Statement 87), that

ultimately are reflected in determining net income of subsequent periods, if not offset by other events. The comprehensive income approach suggested by respondents would require separate Board consideration of how comprehensive income would be displayed, since Concepts Statement 5 does not address that issue. That consideration is beyond the scope of this Statement.

266. The Board concluded that, if an employer's transition obligation or asset is recognized immediately, the effect of that change in accounting should be recognized in a manner consistent with recognition of the effects of other changes in accounting. The Board believes that recognition of the effects of an accounting change through income is widely understood and accepted. To immediately recognize the effects of adopting this Statement in a different manner would be inconsistent with how subsequent adjustments of the transition obligation are recognized and would diminish the understandability and usefulness of the financial statements. Therefore, the Board concluded that the effects of an employer's election to immediately recognize its transition obligation or asset for postretirement benefits should be reported as the effect of an accounting change; employers that elect delayed recognition of the transition obligation or asset should report the recognition of that amount as a component of net periodic postretirement benefit cost, consistent with the manner of reporting the transition effects of Statement 87.

267. The Board also concluded that for individual deferred compensation contracts, the effects of a change in the measurement and recognition of an employer's obligation at the date the change in accounting is adopted should be recognized in a manner consistent with the nature of the benefit provided by the contract. Consequently, the effect of the change in accounting for individual contracts that provide postretirement health or other welfare benefits, measured at the date of the change, is subject to the general transition provisions and effective dates of this Statement (paragraphs 108-114). However, the effect of a change in accounting for other individual deferred compensation contracts is to be recognized as the cumulative effect of a change in accounting in accordance with Opinion 20, effective for fiscal years beginning after March 15, 1991. The Board believed that that delay in the effective date for those contracts should provide sufficient time for communication of the amendment of Opinion 12 to affected employers.

Components of Net Periodic Postretirement Benefit Cost

268. The Board concluded that an understanding of postretirement benefit accounting is facilitated by separately considering the components of net periodic postretirement benefit cost. Those components are service cost, interest cost, actual return on plan assets, amortization of unrecognized prior service cost, gain or loss recognition, and amortization of the transition obligation or asset for employers who elect delayed recognition of the unrecognized obligation or asset existing at the date of initial application of this Statement.

269. A plan with no plan assets, no plan amendments, no gains or losses, and no unrecognized

transition amount would have two components of cost—service cost and interest cost. As employees work during the year in exchange for promised benefits, a *service cost* (compensation cost) accrues. Measurement of that component is discussed in the section on measurement of cost and obligations (paragraphs 166-246). Since the service cost component and the related obligation are measured on a present value basis under this Statement, a second component—*interest cost*—also must be accounted for. Measurement of that component is straightforward once the discount rates are determined; selection of appropriate discount rates is discussed in paragraphs 186-193.

270. A third component of cost exists for a funded plan—the *return* (or possibly loss) *on plan assets*. That component ordinarily reduces net periodic postretirement benefit cost. The interest cost and return on plan assets components represent financial items rather than employee compensation cost and are affected by changes in the employer's financing arrangements. For example, an employer can increase the return on plan assets by making additional contributions to a fund that is segregated and restricted for the payment of the postretirement benefits. An employer can decrease interest cost (and return on plan assets) by using plan assets to purchase nonparticipating life insurance contracts to settle part of the accumulated postretirement benefit obligation of a postretirement life insurance plan.

271. The fourth component of cost is the *amortization of unrecognized prior service cost*, which reflects the increase or decrease in compensation cost as a result of granting, improving, or reducing postretirement benefits attributed, pursuant to this Statement, to periods prior to the plan initiation or amendment. The amortization of unrecognized prior service cost that results from a plan initiation that grants retroactive benefits will increase net periodic postretirement benefit cost; amortization of prior service cost that results from a plan amendment will increase or decrease the net periodic postretirement benefit cost depending on whether the amendment increases or reduces (a negative plan amendment) benefits.

272. The fifth component of cost is the *gain or loss component*. That component either decreases or increases postretirement benefit cost depending on whether the net unrecognized amount is a gain or a loss, whether the actual return on plan assets for a particular period is less than or greater than the expected return on plan assets, and whether an employer makes a decision to temporarily deviate from the substantive plan. That component combines gains and losses of various types and therefore includes both compensation and financial items that are not readily separable.

Conclusions on Other Issues—Single-Employer Defined Benefit Postretirement Plans

Fundamentals of Postretirement Benefit Accounting

273. In applying accrual accounting to postretirement benefits, this Statement accepts three fundamental ideas that are common to pension accounting: delayed recognition of certain

events, reporting net cost, and offsetting liabilities and related assets. Those three features of practice have shaped financial reporting for pensions for many years even though they conflict in some respects with accounting principles applied elsewhere.

274. Delayed recognition means that certain changes in the obligation for postretirement benefits, including those changes that result from a plan initiation or amendment, and certain changes in the value of plan assets set aside to meet that obligation are not recognized as they occur. Rather, those changes are recognized systematically over future periods. All changes in the obligation and plan assets are ultimately recognized unless they are first offset by future changes. The changes that have been quantified but not yet recognized in the employer's financial statements as components of net periodic postretirement benefit cost and as a liability or asset are disclosed.

275. Net cost means that the recognized consequences of events and transactions that affect a postretirement benefit plan are reported as a single amount in the employer's financial statements. That net cost comprises at least three types of events or transactions that might otherwise be reported separately. Those events or transactions—exchanging a promise of deferred compensation in the form of postretirement benefits for employee service, the interest cost arising from the passage of time until those benefits are paid, and the returns from the investment of plan assets—are disclosed separately as components of net periodic postretirement benefit cost.

276. Offsetting means that the postretirement benefit obligation recognized in the employer's statement of financial position is reported net of amounts contributed to a plan specifically for the payment of that obligation and that the return on plan assets is offset in the employer's statement of income against other components of net periodic postretirement benefit cost. That offsetting is reflected even though the obligation has not been settled, the investment of the plan assets may be largely controlled by the employer, and substantial risks and rewards associated with both the obligation and the plan assets are borne by the employer.

Recognition and Measurement of a Plan Initiation or Amendment

277. When a postretirement benefit plan is initiated or amended to increase benefits, credit may be explicitly granted for employee service rendered prior to the date of the plan initiation or amendment. However, a plan initiation or amendment may not explicitly grant prior service credit. Thus it may be unclear whether an obligation for prior service arises for all or some of the participants.

278. A plan initiation or amendment that provides benefits to current retirees can only grant the retirees credit for their prior service, since no future service can be required for them to be entitled to the new or amended benefits. Consequently, an obligation for prior service arises to the extent a plan initiation or amendment provides new or increased benefits to current retirees. A similar assessment can be made for a plan initiation or amendment that provides benefits to other plan participants who have rendered sufficient service to be fully eligible to receive the

new or amended benefits. However, since some of those plan participants have not yet retired and are expected to render additional future service, some respondents argued that a plan initiation or amendment affecting active plan participants fully eligible for benefits may be viewed as prospective. That view acknowledges no obligation for prior service; any obligation would arise as the employees render future service in exchange for the benefits. As applied to active plan participants who are fully eligible for benefits, the latter argument appears to be consistent only with the use of an attribution period that would end at an active plan participant's retirement date, not with an attribution period ending at an active plan participant's full eligibility date.

279. When new or amended benefits are granted to active plan participants who are not yet fully eligible for benefits, the determination of whether those benefits are granted in exchange for past or future service is unclear unless specified by the plan initiation or amendment. Some respondents argued that because eligibility for the new or amended benefits is contingent on rendering future service, the plan initiation or amendment should be viewed only as prospective. Others argued that, consistent with the attribution approach that allocates an equal amount of benefit to each year of service in the attribution period and assuming the plan's benefit formula does not specify the benefits earned for specific years of service, the granting of new or amended benefits should be viewed as partially retroactive, to the extent the benefits are attributable to prior service periods, and partially prospective.

280. The Board noted that if a plan initiation or amendment does not explicitly state whether the new or amended benefits are granted prospectively or retroactively, but affects retirees as well as active plan participants, the plan could be viewed as implicitly granting prior service credit to active plan participants expected to receive the new or amended benefits. Assigning new or amended benefits to prior periods acknowledges that benefits are provided in exchange for employee service over the total credited service period.

281. The Board considered whether a plan initiation should be given the same accounting treatment as a plan amendment. If a plan initiation is viewed as retroactive, presumably any subsequent plan amendment also should be viewed as retroactive unless the plan specifically ignores prior service in determining eligibility for the new or amended benefit. However, if a plan initiation is viewed as prospective, one could view a subsequent amendment to that plan either as retroactive to the date of plan initiation or as prospective.

282. In considering whether plan initiations and amendments should be viewed similarly (that is, both as retroactive or both as prospective), the Board acknowledged the potential difficulty in distinguishing between a plan initiation and plan amendment. For example, if an employer has a health care plan for retirees and decides to provide dental benefits to retirees, one can view the action as an amendment of the postretirement health care plan or as the initiation of a postretirement dental care plan. The Board also was concerned about accounting for other amendments that might be viewed as plan initiations. For example, if a plan providing nominal benefits was initiated on January 1 and then was amended a few months later to increase

benefits, the amended plan could be viewed as the plan that was contemplated when initiated on January 1. The Board concluded that a plan initiation should be accounted for in a manner similar to a plan amendment, unless the plan specifically provides benefits solely in exchange for service after the date of the plan initiation or a future date.

283. The Board also considered whether the effects of a plan initiation or amendment on retirees and other fully eligible plan participants should be viewed as retroactive and the effects on other active plan participants as prospective. In granting new or amended benefits to retirees and other fully eligible plan participants, an employer is implicitly, if not explicitly, granting credit for prior service. However, for active plan participants who have not yet attained full eligibility for those benefits, the new or amended benefits could be provided in exchange for their remaining service to full eligibility for benefits. Some interested parties, particularly consulting actuaries, advised the Board of the difficulties in measuring the service cost component of net periodic postretirement benefit cost and gains and losses if plan amendments were viewed as prospective for some plan participants.

284. Under a prospective approach, the benefits granted at plan initiation and with each subsequent amendment would need to be layered, requiring a repricing of each layer at each measurement date to determine service cost and gains or losses. That repricing could be particularly difficult when the plan does not define the specific periods of service to be rendered in exchange for the benefits and the benefits are defined in kind, rather than in terms of a fixed value or amount of benefit. In addition to the concerns expressed with prospective treatment of a plan initiation or amendment that affects certain active plan participants, the Board noted that negative plan amendments cannot logically be viewed as prospective for those plan participants. Given those factors, and the decision to reduce complexity by attributing the expected postretirement benefit obligation ratably to employees' years of service in the attribution period, the Board concluded that all plan amendments should be viewed as retroactive for all plan participants. Similarly, plan initiations generally should be viewed as retroactive unless the plan initiation specifically disregards prior service in determining eligibility for the new benefits.

Recognition of Prior Service Cost

285. When a plan is amended to increase benefits or a plan is initiated and grants credit for prior service, the accumulated postretirement benefit obligation, based on retroactive allocation of benefits to service in prior years, is greater than before the plan initiation or amendment. As a result, the incremental obligation created by a plan initiation or amendment is reflected immediately as an increase in the accumulated postretirement benefit obligation. Whether that increase should be recognized (a) immediately as postretirement benefit cost for the year of the plan initiation or amendment or (b) on a delayed basis as part of postretirement benefit cost for future periods is arguable, particularly when the plan's terms attribute the increase to employees' prior service.

286. Some Board members support immediate recognition of prior service cost as an expense,

particularly the portion related to existing retirees. Although some intangible economic benefits of a plan initiation or amendment may be received in future periods from benefit improvements for active plan participants, they believe that those intangible benefits do not qualify for recognition as an asset. Therefore, they believe there is little basis for delaying recognition of the underlying prior service cost to future periods. Other Board members believe that a plan initiation or amendment is made with a view to benefiting the employer's future operations through reduced employee turnover, improved productivity, or reduced demands for increases in cash compensation.

287. In its deliberations on Statement 87, the Board concluded that it is reasonable to assume that a plan amendment is the result of an economic decision and that a future economic benefit to the employer exists when benefit increases are granted to active plan participants and retirees. They observed that amortizing the cost of acquiring a future economic benefit over future periods is consistent with accounting practice in other areas. The Board also concluded that a requirement to charge the cost of a retroactive plan initiation or amendment immediately to net periodic pension cost would be an unacceptable change from prior practice. Accordingly, the Board concluded that the increase in the obligation resulting from a pension plan initiation or amendment should be recognized as a component of net periodic pension cost over a number of future periods as the anticipated benefit to the employer is expected to be realized.

288. In considering postretirement benefits, the Board found no compelling reason to recognize the cost of a retroactive plan initiation or amendment in a manner fundamentally different from that required by Statement 87. Thus, this Statement requires recognizing an equal amount of the prior service cost in each remaining year of service to the full eligibility date of each plan participant active at the date of the plan initiation or amendment who is not yet fully eligible for benefits at that date. Other alternatives provided under Statement 87 that recognize the prior service cost more rapidly, such as over the average remaining years of service to full eligibility for benefits of the active plan participants, also are permitted.

289. The Board recognizes that treating any plan amendment as retroactive, even if the new or amended benefits are provided solely in exchange for future service, results in a measure of the accumulated postretirement benefit obligation and of unrecognized prior service cost that may exceed the measure that would result from following the plan terms. The effect of retroactive treatment, however, is consistent with the pattern of ratably attributing the expected postretirement benefit obligation to each year of service in the attribution period. The effects of a higher measure of the accumulated postretirement benefit obligation and unrecognized prior service cost in some cases, as a result of treating prospective changes as retroactive, are consequences that offset the benefits of the simpler methodology provided by a ratable attribution pattern. However, delayed recognition of prior service cost mitigates those effects and net periodic postretirement benefit cost is not expected to be significantly affected.

Recognition of the Effect of a Plan Amendment That Reduces Benefits (Negative Plan Amendment)

290. A plan amendment may reduce rather than increase benefits attributed to prior service. The Board concluded that, consistent with Statement 87, any decrement in the obligation for benefits attributable to prior service should first reduce any existing unrecognized prior service cost arising from the plan's initiation or subsequent benefit increases. Further, the Board concluded that any remaining effects of a negative plan amendment should next reduce any unrecognized transition obligation with any remaining credit generally recognized in a manner consistent with prior service cost; that is, over remaining years of service to full eligibility for benefits of the active plan participants. The Board concluded that those constraints on recognition of the effects of a negative plan amendment are necessary because the effects of reducing a plan promise should not be recognized before the original promise, including the unrecognized transition obligation, is recognized. Immediate recognition of the effects of a negative plan amendment also is precluded because future periods may be affected by an employer's decision to reduce benefits provided under the plan.

Delayed Recognition of Gains and Losses

291. Gains and losses, sometimes called actuarial gains and losses, are changes in either the accumulated postretirement benefit obligation or the fair value of plan assets arising from changes in assumptions and from experience different from that incorporated in the assumptions. For example, gains and losses include the effects on measurement of the accumulated postretirement benefit obligation that result from changes in the assumed health care cost trend rates for postretirement health care plans and actual returns on plan assets greater than or less than the expected rates of return.

292. Some respondents expressed concern about the volatility of a measure of an unfunded postretirement benefit obligation and the practical effects of incorporating that volatility into financial statements. The Board does not believe that volatility in financial statements is necessarily undesirable. If a financial measure purports to represent a phenomenon that is volatile, that measure must reflect the volatility or it will not be representationally faithful.

293. The Board acknowledges that, in the case of the accumulated postretirement benefit obligation, reported volatility may not be entirely a faithful representation of changes in the status of the obligation (the phenomenon represented). It also may reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements. That may be particularly true for postretirement health care plans in light of the current inexperience in measuring the accumulated postretirement benefit obligation for those plans. The difference in periodic measures of the accumulated benefit obligation for a postretirement health care plan, and therefore the funded status of the plan, results partly from the inability to predict accurately for a period, or over several periods, annual expected claims costs, future trends in the cost of health care, turnover rates, retirement dates, dependency status, life expectancy, and other pertinent events. As a result, actual experience often differs

significantly from what was estimated, which leads to changes in the estimates for future measurements. Recognizing the effects of revisions in estimates in full in the period in which they occur may produce financial statements that portray more volatility than is inherent in the employer's obligation.

294. The Board considered those views and concluded that, similar to employers' accounting for pensions, gains and losses should not be required to be recognized immediately as a component of net periodic postretirement benefit cost. Accordingly, this Statement provides for delayed recognition of gains (losses) over future periods to the extent they are not reduced by subsequent losses (gains). The effects of changes in the fair value of plan assets, including the indirect effect of those changes on the return-on-assets component of net periodic postretirement benefit cost, are recognized on a basis intended to reduce volatility. The method used was developed in Statement 87. Both the extent of reduction in volatility and the mechanism adopted to effect it are essentially practical decisions without conceptual basis. The Board believes that the market-related value of plan assets used in this Statement as a device to reduce the volatility of net periodic postretirement benefit cost is not as relevant as the fair value of those assets.

295. Unlike most pension plans, the return on postretirement benefit plan assets may be subject to income tax because of the lack of tax-exempt vehicles for funding those benefits. At present, even if postretirement benefit plan assets are restricted and segregated within a trust, the income generated by those assets generally is taxable. If the plan has taxable income, the assessed tax will reduce the returns available for payment of benefits or reinvestment. The Board concluded that when the trust or other entity holding the plan assets is taxed as a separate entity on the return on *plan assets* (as defined herein), the expected long-term rate of return should be determined by giving consideration to anticipated income taxes under enacted tax law. However, if the tax on income generated by plan assets is not a liability of the plan, but of the employer, the expected long-term rate of return should not anticipate a tax on those earnings, because that tax will be reflected in the employer's accounting for income taxes.

296. The Board had several reasons for adopting the approach required in this Statement for measuring and incorporating the return on plan assets into net periodic postretirement benefit cost. First, it is the same as that used in Statement 87 and is similar, mechanically, to actuarial practices intended to reflect the return on plan assets. As a result, it should be easier for those familiar with pension accounting or actuarial practices to understand and apply. Second, the use of explicit estimates of the return on plan assets avoids the use of discount rates, which are primarily relevant for measuring the accumulated postretirement benefit obligation, as part of a calculation related to the return on plan assets. Therefore, it reflects more clearly the Board's basic conclusion that information about a deferred compensation plan is more understandable if asset-related or financial features of the arrangement are distinguished from the liability-related and compensation cost features.

297. If assumptions prove to be accurate estimates of experience over a number of years, gains or losses in one year will be offset by losses or gains in subsequent periods. In that situation, all

gains and losses would be offset over time, and amortization of unrecognized gains and losses would be unnecessary. The Board was concerned that the uncertainties inherent in assumptions could lead to gains or losses that increase rather than offset, and concluded that gains and losses should not be ignored completely. Actual experience will determine the final net cost of a postretirement benefit plan. The Board concluded that some amortization, at least when the net unrecognized gain or loss becomes significant, should be required.

298. Consistent with Statement 87, this Statement uses a "corridor" approach as a minimum amortization approach. That approach allows a reasonable opportunity for gains and losses to offset each other without affecting net periodic postretirement benefit cost. The Board also noted that the corridor approach is similar in some respects to methods used by some to deal with gains and losses on plan assets for funding purposes. The width of that corridor is related to the market-related value of plan assets and the amount of the accumulated postretirement benefit obligation because the gains and losses subject to amortization are changes in those two amounts. The Exposure Draft proposed that a net gain or loss equal to 10 percent of the greater of those two amounts should not be required to be amortized (and thus included in net periodic postretirement benefit cost). Thus, the width of the resulting corridor would be 20 percent (from 90 percent to 110 percent of the greater balance).

299. Respondents generally agreed with the proposal to shield from recognition gains and losses falling within a defined corridor. However, many of the respondents suggested a wider corridor. They stated that they believe there will be greater volatility of measurement of postretirement benefit obligations than of pension obligations. They suggested that that consideration and the inability to fund postretirement benefit plans (which they believed would provide offsetting asset-related gains and losses) warrant a wider corridor to further mitigate potential swings in net postretirement benefit cost from one period to the next.

300. The effects of widening the corridor to 20 percent of the greater of the accumulated postretirement benefit obligation or market-related value of plan assets were tested in a number of different scenarios. The results of that study showed that widening the corridor would have little effect on mitigating the volatility of net periodic postretirement benefit cost; the significant factor in mitigating that volatility is the period over which unrecognized gains or losses in excess of the corridor are recognized. The Board concluded that understandability and comparability would be enhanced by retaining the approach followed for pension accounting.

301. Gains and losses also may be recognized immediately or on a delayed basis using any systematic method of amortizing unrecognized gains and losses, provided the method is consistently followed and that it does not result in less rapid recognition of gains and losses than the minimum amortization discussed in paragraph 298. Amortization of unrecognized net gains or losses is based on beginning-of-year balances. If an employer elects to recognize gains and losses immediately, the amount of any net gain in excess of a net loss previously recognized in income shall first offset any unrecognized transition obligation, and the amount of any net loss in excess of a net gain previously recognized in income shall first offset any unrecognized

transition asset. That constraint was added because Board members believe that gains (losses) should not be recognized before the underlying unfunded (overfunded) accumulated postretirement benefit obligation is recognized.

302. In some cases an employer may assume a benefit obligation for current and past benefit payments that differs from the substance of the employer's commitment. For example, on the basis of the mutually understood terms of the substantive plan, an employer may anticipate for accounting purposes that any shortfall resulting from current year benefit payments in excess of the employer's substantive plan cost and participant contributions for the year will be recovered from increased participant contributions in the subsequent year. However, the employer may subsequently determine that increasing participant contributions for the prior year's shortfall is onerous and make a decision to bear the cost of the shortfall for that year. That is, an employer may make a decision not to retrospectively adjust participants' contributions to recover the shortfall. The Board concluded that the gain or loss from such a temporary deviation from the substantive plan should be immediately recognized as a gain or loss, without the benefit of the corridor or other delayed recognition alternatives. Because the effect of the deviation from the substantive plan has no future economic benefit to the employer, and relates to benefits already paid, the Board believes that delayed recognition of that effect would be inappropriate.

Minimum Liability

303. The Exposure Draft proposed that, similar to Statement 87, a minimum liability should be prescribed to limit the extent to which the delayed recognition of the transition obligation, plan amendments, and losses could result in omission of liabilities from an employer's statement of financial position. The minimum liability was defined as the unfunded accumulated postretirement benefit obligation for retirees and other fully eligible plan participants. The Board believed that that measurement represented a threshold below which the recognized liability would not be sufficiently representationally faithful. The proposed minimum liability provisions would have been effective five years after the effective date of this Statement.

304. Respondents generally disagreed with prescribing the minimum liability that should be recognized. They believed that the proposed minimum liability provision represented a departure from accrual accounting and was inconsistent with the provisions of this Statement that provide for delayed recognition of gains and losses, prior service cost, and an employer's transition obligation. Respondents stated that unlike pensions, postretirement benefit obligations do not vest, as that term is used in its legal sense. They observed that the minimum liability provisions in Statement 87 approximate the statutory liability a U.S. employer would face if its pension plan were terminated. Currently, there are no similar statutory requirements for postretirement health care or welfare benefits. Some respondents also believed that the minimum liability provision would be confusing because it introduces an alternative measure of an employer's postretirement benefit obligation.

305. The Board concluded that this Statement should not require recognition of a minimum

liability. The field test of the Exposure Draft provisions suggested that, ignoring the effects of gains and losses and plan amendments, the minimum liability provision for mature companies as defined in that study (companies with a ratio of one retiree to two to six active employees) generally would be inoperative after eight years. For companies with a higher retiree to active employee ratio, the field test suggested that the minimum liability provisions might be operative for more than 10 years. In other words, for possibly 10 or more years the minimum liability provisions could be effective solely as a result of phasing in recognition of the transition obligation. The Board concluded that the transition provisions of this Statement that provide for the delayed recognition of an employer's obligation for postretirement benefits at the date this Statement is initially applied should not be overridden by a requirement to recognize a liability that would accelerate recognition of that obligation in the statement of financial position.

306. The Board considered and decided not to amend Statement 87 to eliminate its minimum liability provision. Because most pension plans were thought to be adequately funded when Statement 87 was issued, the minimum liability provision served to identify those exceptional situations in which the pension plan was underfunded. However, it is widely acknowledged that postretirement benefit plans are significantly or totally underfunded. As a result, recognition of a minimum liability for such plans would be commonplace rather than an exception.

307. Some Board members believe that a liability that reflects only the accrued and unfunded postretirement benefit cost, in and of itself, is not a relevant or reliable representation of an employer's probable future sacrifice if recognition of significant losses, prior service costs, or the transition obligation has been delayed. They support retaining the minimum liability provision proposed in the Exposure Draft for the reasons described in paragraph 303. They observe that the liability for accrued and unfunded postretirement benefit cost does not purport to be a measure of the employer's present obligation in most cases; rather, it is the residual resulting from an allocation process. To the extent that one assumes that the employer is a going concern and that a postretirement benefit plan will continue, the employer's probable future sacrifice is represented by benefits to which retirees and other fully eligible plan participants are entitled and the portion of expected future benefits earned by other active plan participants. That probable future sacrifice can only be determined by considering the current funded status of the plan.

Measurement of Plan Assets

308. The Board considered whether employer assets intended to be used for the payment of postretirement benefits, including funds set aside in a separate trust or similar funding vehicle, should be included in plan assets. The Board concluded that if those assets can be used for other purposes at the employer's discretion, they should not be considered to be plan assets. In measuring the funded status of a postretirement benefit plan, the Board concluded that it is appropriate and consistent with pension accounting to include in plan assets only those assets that are restricted for the purpose of paying the plan's postretirement benefit obligations. Some respondents questioned whether certain funding vehicles can be restricted solely for the provision of postretirement benefits, as opposed to funding both active employees' and retirees'

benefits, and would, therefore, qualify as plan assets. Whether a funding vehicle can be restricted solely for the payment of retirees' benefits is subject to legal, not accounting, interpretation.

309. The Board concluded that plan investments should be measured at fair value for purposes of this Statement, except as provided in paragraph 57 for purposes of determining the extent of delayed recognition of gains and losses. Fair value is the most relevant information that can be provided for assessing both the plan's ability to pay benefits as they come due and the future contributions necessary to provide for benefits already promised to employees. The relevance of fair value outweighs objections to its use based on difficulty of measurement. The same reasons led to a similar decision in Statements 35 and 87.

310. Measuring investments at fair value could introduce volatility into the financial statements as a result of short-term changes in fair values. Some respondents indicated that that volatility would be meaningless or even misleading, particularly because of the long-run nature of the postretirement benefit commitment or because plan investments are often held for long periods, thus providing the opportunity for some gains or losses to reverse. As noted in paragraphs 58-60, the Board concluded that the difference between the actual return on plan assets and the expected return on plan assets could be recognized in net periodic postretirement benefit cost on a delayed basis. That conclusion was based on (a) the probability that at least some gains would be offset by subsequent losses, and vice versa, and (b) arguments that immediate recognition would produce unacceptable volatility and would be inconsistent with the present accounting model.

311. The Board also concluded that, similar to the conclusion in Statement 87, including accrued postretirement benefit costs as plan assets for purposes of the disclosure of funded status (paragraph 74(c)) (a) would be inappropriate because that amount has not been funded (contributed) and (b) would unnecessarily complicate the recognition and disclosure requirements of this Statement. Similarly, the Board concluded that elimination from plan assets of all securities of the employer held by the plan would be impractical and might be inappropriate absent a decision that the financial statements of the plan should be consolidated with those of the employer. However, the Board concluded that disclosure of the amount of those securities held is appropriate and should be required.

Measurement Date

312. The Board concluded that the prescribed measurement date should be responsive to the difficulties inherent in measurement of the accumulated postretirement benefit obligation as well as the time required to obtain actuarial valuation reports. The Board believed those considerations justified some flexibility in selecting the date at which the accumulated postretirement benefit obligation and plan assets should be measured.

313. Measuring plan assets as of the date of the financial statements does not present very significant or unusual problems; the difficulty arises primarily with measurement of the

accumulated postretirement benefit obligation. The Board concluded that it should be feasible to provide information about the accumulated postretirement benefit obligation as of the date of the financial statements based on a valuation performed at an earlier date with adjustments for relevant subsequent events (especially employee service) after that date.

314. The Board concluded that the benefits of having information on a timely basis and measured consistently with other financial information will usually outweigh the incremental costs. The Board acknowledges that practical problems may sometimes make it costly to obtain information, especially information about the accumulated postretirement benefit obligation and related components of net periodic postretirement benefit cost, as of the date of the financial statements. The Board concluded that the information required by this Statement should be as of a date not earlier than three months before the date of the financial statements. That measurement date is consistent with the measurement date prescribed by Statement 87. Measurements of postretirement benefit cost for interim and annual financial statements should be based on the assumptions used for the previous year-end financial reporting unless more recent measures of both plan assets and the accumulated postretirement benefit obligation are available, for example, as a result of a significant event, such as a plan amendment.

Settlements and Curtailments

315. This Statement provides for delayed recognition of the effects of plan initiations and amendments and gains and losses arising in the ordinary course of operations. In certain circumstances, however, recognition of some or all of those delayed effects may be appropriate. Paragraphs 316-332 discuss the basis for the Board's conclusions on settlement and curtailment accounting for postretirement benefit plans, which draw on the basis for conclusions in Statement 88. Except as discussed in paragraph 325, the Board's conclusions are the same as those prescribed in Statement 88 for a settlement or a curtailment of a defined benefit pension plan.

316. Settlements and curtailments are events that require income or expense recognition of previously unrecognized amounts and adjustments to liabilities or assets recognized in the employer's statement of financial position. The Board concluded that, similar to employers' accounting for pensions, previously unrecognized prior service cost, including any unrecognized transition obligation, and the previously unrecognized net gain (including any unrecognized transition asset) or loss should be recognized in the period when all of the following conditions are met:

a. All postretirement health care or other welfare benefit obligations under the plan are settled.
b. Defined benefits are no longer accrued under the plan.
c. The plan is not replaced by another defined benefit plan.
d. No plan assets remain.
e. The employees are terminated.
f. The plan ceases to exist as an entity.

317. It is not uncommon for some, but not all, of the above conditions to exist in a particular situation. For example, the accumulated postretirement benefit obligation may be settled without terminating the plan, or a plan may be suspended so that no further benefits will accrue for future services but its obligations are not settled. In other situations one or more of the above conditions may apply to only part of a plan. For example, one plan may be divided into two plans, one of which is then terminated, or one-half of the employees in a plan may terminate employment and the obligation for their benefits may be settled.

318. If recognition of previously unrecognized prior service cost and net gain or loss were required only when a plan is completely terminated and settled and if no recognition occurred when a plan is partially curtailed or an obligation is partially settled, anomalies and implementation problems would result. For example, if one employer had two plants with separate plans and another employer had two plants with a single plan, the accounting result of closing one plant and settling the related obligation would be a recognizable event for one employer but not for the other. If recognition were an all-or-nothing proposition, it would be necessary to determine when the extent of settlement or curtailment is sufficient for recognition. If all employees but one from a large group are terminated and obligations to the terminated employees are settled, presumably the accounting should reflect a plan termination. But it is not clear whether that accounting should apply if 5 percent, 10 percent, or 25 percent of the original group were to remain. The Board concluded in Statement 88 and reconfirmed in this Statement that a complete plan termination and settlement need not occur to recognize previously unrecognized amounts.

Settlement of the Obligation

319. The Board concluded that settlement of all or part of the accumulated postretirement benefit obligation should be the event that requires recognition of all or part of the previously unrecognized net gain (including any unrecognized transition asset) or loss. Delayed recognition of gains and losses under this Statement is based in part on the possibility that gains or losses occurring in one period will be offset by losses or gains in subsequent periods. To the extent that the accumulated postretirement benefit obligation has been settled, the possibility of future gains and losses related to that obligation and the assets used to effect the settlement is eliminated.

320. Settlement of all or a large portion of the accumulated postretirement benefit obligation also may be viewed as realization of past gains or losses associated with that portion of the obligation and the assets used to effect the settlement. That realization would not be affected by the employer's subsequent decision to undertake or not to undertake future defined benefit obligations.

321. The Board acknowledges that other actions an employer can take, especially those related to plan assets, can affect the possibility of a subsequent net gain or loss. For example, an employer may avoid or minimize certain risks by investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated

payment dates of benefits, as with a dedicated bond portfolio.

322. Settlement differs from other actions in that (a) it is irrevocable, (b) it relieves the employer (or the plan) of primary responsibility for the obligation, and (c) it eliminates significant risks related to the obligation, such as the risk that participants will live longer than assumed, and to the assets used to effect the settlement. The decision to have a dedicated bond portfolio can be reversed, it does not relieve the employer of primary responsibility for the obligation, and such a strategy does not eliminate various risks, such as mortality risk and the escalating cost of providing the benefits. The Board concluded that the circumstances requiring gain or loss recognition should be defined narrowly.

323. The Board recognizes that changes in the previously estimated values of the accumulated postretirement benefit obligation and the plan assets may become evident at the time the obligation is settled. For example, the interest rates inherent in the price actually paid for insurance contracts that settle an obligation may be different from the assumed discount rates. Some respondents suggested that those changes should be recognized immediately in income as a gain or loss directly resulting from the settlement. The Board concluded that, based on the measurement principles adopted in this Statement, those changes reflect factors expected to be considered in the measurement of the postretirement benefit obligation and plan assets. The Board also concluded that those amounts should be included with the previously unrecognized net gain or loss before a pro rata portion of that amount is recognized.

324. This Statement requires measurement of a pro rata portion of the unrecognized net gain or loss based on the decrease in the accumulated postretirement benefit obligation resulting from a settlement. The Board acknowledges that a decrease in the amount of plan assets also can affect the possibility of future gains and losses. However, the Board concluded that it would be simpler and more practical to base the measurement only on the obligation settled.

325. Under Statement 88, a gain resulting from settlement of a pension obligation is measured without regard to any remaining unrecognized transition obligation. In contrast with the nature of the transition obligation that may arise under Statement 87, any unrecognized transition obligation for postretirement benefits is likely to include a significant amount of previously unrecognized current service cost and interest cost. For an ongoing plan, this Statement requires that for an employer that elects immediate recognition of gains or losses, any net gain for the year that does not offset a loss previously recognized in income must first reduce any remaining unrecognized transition obligation. Similarly, the Board has concluded that any gain arising from a settlement should be reduced by any unrecognized transition obligation; only the excess is recognized as a settlement gain. The Board concluded that an employer should not be permitted to accelerate recognition of gains if the underlying obligation that was remeasured, causing those gains to arise, has not yet been recognized.

Curtailment of the Plan

326. One basis for delayed recognition of prior service cost is the likelihood of future economic benefits to the employer as a result of a plan initiation or amendment. Those benefits, in the Board's view, are derived from the future services of active plan participants, and the amortization of unrecognized prior service cost is based on those services. A curtailment, as defined in this Statement, is an event that significantly reduces the expected years of future service of present active plan participants or eliminates for a significant number of active plan participants the accrual of defined benefits for some or all of their future services.

327. The Board concluded that reduction of the expected years of future service of the work force or elimination of the accrual of defined postretirement benefits for a significant number of active plan participants raises doubt about the continued existence of the future economic benefits of unrecognized prior service cost. Therefore, the Board concluded that any remaining unrecognized prior service cost, including any unrecognized transition obligation, should be recognized when it is probable that a curtailment will occur, the effects are reasonably estimable, and the net result of the curtailment (as described in paragraphs 97 and 98) is a loss.

328. The Board also considered whether either the settlement or the termination of one plan and the adoption of a substantially equivalent replacement plan should trigger recognition of prior service cost. The Board concluded that neither of those events, absent a curtailment, raises sufficient doubt as to the existence of future economic benefits to trigger that recognition.

329. A curtailment may directly cause a decrease in the accumulated postretirement benefit obligation (a gain) or an increase in the accumulated postretirement benefit obligation (a loss). For example, the accumulated postretirement benefit obligation may decline if active plan participants who are not yet eligible for benefits are terminated (a gain). On the other hand, the accumulated postretirement benefit obligation may increase if an event occurs that causes active plan participants fully eligible for benefits to leave earlier than previously expected (a loss).

330. Conceptually, the Board concluded that it would be appropriate to recognize those gains or losses immediately to the extent they do not represent the reversal of previously unrecognized losses or gains. However, the obligation eliminated or created by a curtailment may not be independent of previously unrecognized losses or gains. For example, part of that obligation could relate to past changes in actuarial assumptions about the discount rates that produced gains or losses not yet fully recognized. To illustrate, if in year 1 the employer reduces the assumed weighted-average discount rate from 9 percent to 8 percent, any accumulated postretirement benefit obligation is increased, resulting in an unrecognized loss. If in year 2 the employer terminates active plan participants, the obligation related to their nonvested accumulated benefits is eliminated and a gain arises, which is, at least in part, a reversal of the previously unrecognized loss.

331. The Board concluded that, similar to Statement 88, a curtailment gain or loss as defined in

paragraph 97 (which does not include recognition of prior service cost) should first be offset to the extent possible against the plan's previously existing unrecognized net loss or gain. Any remainder of the curtailment gain or loss cannot, at least in an overall sense, be a reversal of unrecognized amounts, and, therefore, recognition of that remainder is appropriate.

332. The Board considered whether curtailment gains should be recognized before the curtailment occurs. It concluded that continuing the delayed recognition feature of this Statement for a curtailment gain should be retained until the related active plan participants terminate or the plan suspension or amendment is adopted. That is consistent with Statement 88 and Opinion 30 and avoids the inconsistent results that would otherwise occur if the curtailment gain is directly related to a disposal of a segment of a business.

Measurement of Special Termination Benefits

333. FASB Statement No. 74, *Accounting for Special Termination Benefits Paid to Employees,* acknowledged that other benefits, in addition to pensions, may be offered pursuant to a special termination arrangement and should be included in measuring the termination expense. Statement 88, which superseded Statement 74, retains that scope and therefore applies to other benefits in addition to pensions. However, the Board concluded that reiterating the applicability of Statement 88 is necessary, since practice may have been to exclude postretirement health care costs from the measurement of termination benefits.

334. The primary conclusion of the Board in Statement 74 was that the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. That conclusion is incorporated in Statement 88. The cost of other contractual termination benefits provided by the existing terms of a plan that are payable only in the event of employees' involuntary termination of service due to a plant closing or a similar event should be recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated.

335. Paragraph 3 of Statement 74 stated:

> The termination of employees under a special termination benefit arrangement may affect the estimated costs of other employee benefits, such as pension benefits, because of differences between past assumptions and actual experience. If reliably measurable, the effects of any such changes on an employer's previously accrued expenses for those benefits that result directly from the termination of employees shall be included in measuring the termination expense. [Footnote reference omitted.]

Statement 88 superseded that paragraph and provides that a gain or loss in a plan arising as a direct result of a curtailment, including a curtailment resulting from an offer of special termination benefits, is first offset against any previously existing unrecognized net loss or gain for that plan and any excess is then recognized (paragraph 13).

336. The Board considered the following three alternative measures of the termination expense [37] arising from the acceptance of an offer of special postretirement health care or other welfare termination benefits:

a. The difference between (1) the accumulated postretirement benefit obligation under the existing plan that would have been attributed to service to date assuming that active plan participants not yet fully eligible for benefits would terminate at their full eligibility date and that fully eligible active plan participants would retire immediately, without considering any special termination benefits, and (2) the remeasured accumulated postretirement benefit obligation based on the special termination benefits
b. The difference between (1) the accumulated postretirement benefit obligation attributed to service to date and (2) the remeasured accumulated postretirement benefit obligation based on the special termination benefits
c. The difference between (1) the actuarial present value of the postretirement benefits an employee would have received if the employee had terminated voluntarily immediately before the offer and (2) the actuarial present value of the postretirement benefits the employee is expected to receive after accepting the offer.

337. The Board concluded that the first alternative was appropriate because it better reflects the exchange. Unlike the second alternative, it recognizes the incentive offered in exchange for termination earlier than expected. The first alternative becomes more compelling when one considers the offer of special termination benefits for fully eligible active plan participants. For those employees, there may be no incentive in the form of benefits not already available. Under the first alternative, the effects of the change in the expected retirement dates for employees who accept the offer may be a curtailment loss pursuant to paragraphs 97-99.

338. In contrast, the third alternative ignores the notion that the obligation to provide postretirement benefits arises with the rendering of employee service. That notion underlies the accounting for all deferred compensation contracts. The Board also noted that the third alternative fails to recognize that the termination benefit incentive for an employee one year away from eligibility for retirement differs from the incentive for an employee five years away.

Disclosure

General Considerations

339. Decisions on disclosure requirements require evaluating and balancing considerations of relevance, reliability, and cost. Relevance and reliability are characteristics that make information useful for making decisions and that make it beneficial to require disclosure of some information. Benefits to users that are expected to result from required disclosures must be compared with the costs of providing and assimilating that information. Evaluating individual disclosures relative to those criteria is generally a matter of judgment. Cost, for example, is affected by several factors, such as the number of different plans and the difficulty of

aggregating or meaningfully summarizing some disclosures. As the total amount of disclosure increases, consideration must be given to whether the incremental cost to both preparers and users of additional disclosure may be greater than the benefit of the additional information. Conversely, there is also a cost of not disclosing information. The absence of certain disclosures may directly affect the ability of financial statement users to make well-informed decisions.

340. Many of the disclosure requirements arise as a result of provisions of this Statement that reflect practical, rather than conceptual, decisions. For example, the components of net periodic postretirement benefit cost are disclosed because the recognized consequences of events and transactions affecting a postretirement benefit plan are reported as a single amount that includes at least three types of transactions that conceptually should be reported separately. The effects of those events or transactions—the exchange of employee service for deferred compensation in the form of postretirement benefits, interest cost reflecting the passage of time until those benefits are paid, and the returns from the investment of plan assets—are therefore disclosed. Similarly, the reconciliation of the funded status of the plan(s) is disclosed as a result of the decision to exclude certain obligations and assets from the statement of financial position due to provisions that permit delayed recognition of (a) the transition obligation, (b) the effect of certain changes in the measure of an employer's accumulated postretirement benefit obligation, and (c) the effect of certain changes in the value of plan assets set aside to meet that obligation. Although those effects are identified and measured, they are not required to be recognized in the financial statements as they arise.

341. Many of the disclosures required by this Statement are similar to required disclosures for pension plans. Some studies of the pension disclosures required by Statement 87 have suggested they are valuable because of the information provided.

Specific Disclosure Requirements

Descriptive information

342. Respondents generally agreed with disclosure of information about plan provisions and employee groups. The Board concluded that a brief description of the plan that is the basis for the accounting (the substantive plan), including any modifications of the existing cost-sharing provisions or increases in monetary benefits that are encompassed by the substantive plan, the employee groups covered, and the types of benefits provided, could assist users in understanding the reported effects of the plan on the employer's financial statements. The Board also concluded that financial statements should disclose the nature and effects of significant changes in the factors affecting the computation of the accumulated postretirement benefit obligation and related cost recognized in the financial statements. Any other significant or unusual matters, such as the effect of a business combination, also should be disclosed to enhance a user's understanding of the impact of those matters on an employer's financial position and results of operations.

343. Many postretirement benefit plans currently in existence are unfunded. For those that are

funded, the Board concluded that disclosure of the funding policy would be useful in understanding differences between funding and accounting for that plan. Information that highlights any changes in funding policies also can be useful in assessing future cash flows.

Net periodic postretirement benefit cost information

344. Most respondents indicated that information about an employer's net periodic postretirement benefit cost would be useful. As with pensions, the cost of providing postretirement benefits comprises several components. Disclosure of the components will, over time, increase the general understanding of the nature of postretirement benefit cost, the reasons for changes in that cost, and the relationship between financing activities and employee compensation cost.

Information about obligations and assets

345. Most respondents who addressed the proposed disclosures agreed with disclosures about the funded status of the postretirement benefit plan. They stated that it provides information that is important to an understanding of the economics of the plan. Some respondents indicated that as part of that disclosure, it is important to present the components of the accumulated postretirement benefit obligation. The Exposure Draft proposed disclosure of the vested postretirement benefit obligation to provide information about the employer's obligation to retirees and other former employees, and active employees assuming they terminated immediately. The Board believed the information required to measure the vested postretirement benefit obligation would be available and that no significant incremental cost would be associated with providing that disclosure.

346. Most respondents opposed disclosure of the vested postretirement benefit obligation. They said the disclosure would be misleading because the term *vested,* although used in its accounting sense, could be misunderstood to imply a legal obligation. Although an employer may have a social or moral obligation to provide the postretirement benefits that have been earned, employers indicated that they currently do not have a statutory requirement to provide those promised benefits, unlike their legal obligation to provide certain vested pension benefits. In addition, respondents observed that if a postretirement benefit plan were terminated, the actual liability would very likely differ from the amount proposed to be measured as the vested obligation.

347. The Board accepted those arguments and concluded that disclosure of the vested postretirement benefit obligation should not be required. However, the Board added paragraph 74(c)(2), which requires disaggregated information about the accumulated benefit obligation for retirees, other fully eligible plan participants, and other active plan participants. Respondents suggested those disclosures would be more useful.

348. Management has a stewardship responsibility for efficient use of plan assets just as it does

for operating assets. The Board concluded that disclosure of general information about the major types of any plan assets (and nonbenefit liabilities, if any) and the actual amount of return on plan assets for the period is useful in assessing the profitability of investment policies and the degree of risk assumed.

349. The Board concluded that a reconciliation of the amounts included in the employer's statement of financial position to the funded status of the plan's accumulated postretirement benefit obligation is essential to understanding the relationship between the accounting for and the funded status of the plan. The Board acknowledges that the amount recognized in the financial statements as a net postretirement benefit liability or asset pursuant to this Statement generally will not fully reflect the underlying funded status of the plan, that is, the plan assets and the accumulated postretirement benefit obligation for an overfunded or underfunded plan.

Information about assumptions

350. The Exposure Draft proposed disclosure, if applicable, of the weighted-average assumed discount rate, rate of compensation increase, health care cost trend rate, expected long-term rate of return on plan assets, and, for plans whose income is segregated from the employer's income for tax purposes, the estimated income tax rate on the expected return on plan assets. Most respondents who addressed the disclosure issues supported disclosure of the significant assumptions used in measuring an employer's postretirement benefit obligation and cost. A few respondents, however, maintained that a more descriptive disclosure about the assumed health care cost trend rates would be more useful. They noted that a weighted-average rate can mask differences in an employer's assumptions about year-by-year health care cost trend rates. For example, two employers could report the same weighted-average health care cost trend rate even though they made significantly different assumptions about future trends in health care costs and have very different expected payment schedules.

351. The Board concluded that descriptive information about an employer's assumed health care cost trend rates would be more useful than disclosure of a weighted-average rate. Therefore, this Statement requires disclosure of the assumed health care cost trend rate(s) used to measure the expected cost of benefits covered by the plan (gross eligible charges) for the year following the measurement date and a more general description of the direction and pattern of change in the assumed trend rates thereafter. The Board believes that disclosure will result in more comparable and understandable information about the assumptions used by employers in measuring their postretirement benefit obligations and costs.

352. The Board concluded that the weighted-average assumed discount rate, rate of compensation increase, and long-term rate of return on plan assets should be required to be disclosed as proposed in the Exposure Draft. In determining those weighted averages, employers should consider both the timing and amount of the expected benefit payments, compensation increases, or return on plan assets. The weighted-average discount rate reflects an assumption that significantly affects the computation of the accumulated postretirement benefit

obligation and net periodic postretirement benefit cost, as might the weighted-average rate of compensation increase for pay-related plans. Those disclosures assist in assessing the comparability of that information among employers. Because the weighted-average assumed long-term rate of return on plan assets is expected to differ from the weighted-average discount rate, the Board concluded that disclosure of that assumption should be required. As proposed in the Exposure Draft, disclosure of the estimated income tax rate on the return on plan assets is required for plans whose income is segregated from the employer's income for tax purposes.

353. This Statement also requires disclosure of the effect on the current measurement of the accumulated benefit obligation for postretirement health care benefits and the combined service cost and interest cost components of net periodic postretirement benefit cost, assuming a one-percentage-point increase in the health care cost trend rates for each year following the measurement date, holding all other assumptions constant. Respondents generally did not support disclosure of the sensitivity of reported amounts to particular assumptions. Some respondents asserted that disclosure of sensitivity information would diminish the credibility of the amounts reported in the financial statements and would ignore the effects of changes in other assumptions. They also noted that the effects of a one-percentage-point change are not linear, reducing, therefore, the predictive value of the information and its usefulness. Other respondents who supported sensitivity disclosures stated that the information would assist users in judging the sensitivity of the measures of an employer's postretirement benefit obligation and cost to changes in one of its significant underlying assumptions and would provide information about the potential impact of subsequent events different from that assumed.

354. Measuring the sensitivity of the accumulated postretirement benefit obligation and the combined service and interest cost components to a change in the assumed health care cost trend rates requires remeasuring the accumulated postretirement benefit obligation as of the beginning and end of the year. That measurement should be possible at minimal incremental cost as part of the actuarial valuation needed to develop the basic information required by this Statement. The Board concluded that requiring that sensitivity information will assist users in assessing the comparability of information reported by different employers as well as the extent to which future changes in assumptions or actual experience different from that assumed may affect the measurement of the obligation and cost. In addition, the sensitivity information may assist users in understanding the relative significance of an employer's cost-sharing policy as encompassed by the employer's substantive plan.

355. Sensitivity disclosures were initially proposed in accounting for pension costs. However, the Board ultimately decided not to require those disclosures for pensions because the cost of providing that information was viewed as outweighing the benefits to users. The Board concluded that the need for sensitivity information is more compelling for postretirement health care measurements. Financial statement users are considerably less familiar with postretirement health care measurements than with pension measurements and with the subjectivity of the health care cost trend rate and the significant effect that assumption may have on measurement of the postretirement health care obligation. The Board acknowledges that the effects of percentage-point changes are not linear but concluded that the significance of the sensitivity

disclosure outweighs concerns about users erroneously extrapolating from the amounts disclosed.

356. Some Board members believe the volume of disclosures required by this Statement is excessive and further contributes to the already extensive disclosures required in general-purpose financial statements. They believe that at some point the sheer volume of all required disclosures may overwhelm users' ability to assimilate information and focus on the more important matters. In particular, those Board members do not support the required sensitivity disclosures because they highlight only one aspect of the postretirement benefit obligation and cost. Similar sensitivity requirements could be imposed for other aspects of this Statement's requirements and, for that matter, any accounting estimate. They are also concerned that sensitivity disclosures may confuse or mislead users who attempt to use the information to make their own estimates of measures of the obligation and cost in different scenarios, without realizing the limitations of the disclosure.

Two or More Plans

357. Under certain circumstances, this Statement permits combining two or more *unfunded* plans for financial accounting and reporting purposes. Plans that provide different benefits to the same group of participants may be combined. For example, an employer may have separate medical care, dental care, and eye care plans that provide benefit coverage to all retirees of the company. Similarly, an employer may combine two or more unfunded plans that provide the same benefits to different groups of plan participants. For example, an employer may have identical postretirement medical care plans at each of its operating locations. This Statement permits combining plans in those situations because the differences in the plans are not substantive. Combining information in those cases results in combined measurements for accounting and disclosure purposes.

358. The Board concluded that an employer with one well-funded plan and another less well funded or unfunded plan is in a different position than an employer with similar obligations and assets in a single plan. Netting the plan assets of one plan against the net unfunded obligation of another would be an inappropriate disclosure of the unfunded obligation if those assets cannot be used to settle that obligation. That conclusion is consistent with existing generally accepted accounting principles that generally preclude offsetting assets and liabilities unless a right of setoff exists. The Exposure Draft proposed separate disclosure by over- and underfunded plans. However, the Board concluded that limiting the requirement for separate disclosure to the accumulated postretirement benefit obligation and the fair value of plan assets for plans with assets less than the accumulated postretirement benefit obligation (underfunded plans) would provide satisfactory information about the financial condition of an employer's plans and would reduce the cost of providing the required disclosures.

Different Accounting for Certain Small Employers

359. The 1985 FASB Exposure Draft, *Employers' Accounting for Pensions,* recognized that the

cost of compliance with a pension standard was relatively greater for small employers than for large employers and more likely to exceed the perceived benefits. In that Exposure Draft, the Board tentatively concluded that the different relative costs and benefits might justify reduced disclosure requirements.

360. However, the Board ultimately concluded that the measurement of pension costs and recognition of pension liabilities should not differ for small or nonpublic employers, in part because evidence from users of financial statements of those employers did not support a different approach. Further, in the Board's view, the existence of a separate set of measurement requirements or a range of alternatives for certain employers probably would not reduce costs significantly, but would add complexity and reduce the comparability and usefulness of financial statements.

361. Similarly, the Board does not believe that postretirement benefit plans for small employers are sufficiently different from the plans of larger employers to warrant fundamentally different measurement and recognition or disclosure requirements. Although the costs of applying this Statement may be relatively higher for small employers, the postretirement benefit obligations of those employers are no different in nature from the postretirement benefit obligations of larger employers. The measurement provisions and effective date of this Statement take into account the data limitations of certain employers and the cost of measuring expected postretirement benefit costs. Paragraph 38 provides for the use of claims experience of other employers in developing current per capita claims cost. Paragraph 41 permits the use of certain alternative approaches to developing assumed per capita claims cost. Therefore, the Board concluded that the requirements of this Statement should apply to all employers.

362. The Exposure Draft proposed a 2-year delay in the effective date for nonpublic employers whose plans all had fewer than 100 participants. Respondents generally agreed with the proposed delay in the effective date, although some suggested that the size criterion be increased to encompass larger groups of plan participants. Those respondents were concerned about the availability of data and the general lack of experience in measuring the postretirement benefit obligations for smaller plan populations.

363. The effective date of this Statement is delayed 2 years for those nonpublic employers whose plans in the aggregate have fewer than 500 participants. The size criterion was increased in response to the concerns expressed by respondents. The Board concluded that small employers and the professionals serving those employers may need additional time to obtain and evaluate the necessary data including, perhaps, tailoring data collected by actuaries or insurers for use in developing the assumed per capita claims cost by age. The Board concluded that a delayed effective date is a practical and appropriate means for facilitating adoption of this Statement by those employers.

Different Accounting for Certain Industries

364. For some employers subject to certain types of regulation (rate-regulated enterprises) or

for employers that have certain types of government contracts for which reimbursement is a function of cost based on cash disbursements, the effects of the requirement to accrue the cost of postretirement benefits (the difference between the cost accrued and the pay-as-you-go cost for a period) may not be recoverable currently. The Board recognizes the practical concerns of those employers but concluded that the cost of a promise to provide postretirement benefits to qualifying employees is not changed by the circumstances described. The Board concluded that this Statement should include no special provisions for those employers. For some rate-regulated enterprises, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, may require that the difference between net periodic postretirement benefit cost as defined in this Statement and amounts of postretirement benefit cost considered for rate-making purposes be recognized as an asset or a liability created by the actions of the regulator. Those actions of the regulator change the timing of recognition of net periodic postretirement benefit cost as an expense; they do not otherwise affect the requirements of this Statement.

Other Situations and Types of Plans

Contracts with Insurance Companies

365. The Board concluded that some contracts with insurance companies are in substance forms of investments and that the use of those funding arrangements should not affect the accounting principles for determining an employer's net periodic postretirement benefit cost. If those contracts have features linked with the insurance company's possible future obligation to pay benefits, their fair values may be difficult or impossible to determine. Although the Board concluded that fair value should be the measurement basis for all types of investments, it acknowledges that for some contracts the best available estimate of fair value may be contract value.

366. The Board recognizes that, except for single-premium life insurance contracts, there are few, if any, contracts at the present time that unconditionally obligate an insurance company to provide most forms of postretirement benefits. However, some insurance contracts, such as single-premium, nonparticipating life insurance contracts, do effectively transfer the primary obligation for payment of benefits from the employer (or the plan) to the insurance company. In those circumstances, the premium paid for the benefits attributed to the current period is an appropriate measure of postretirement benefit cost for that period. The Board concluded that the purchase of a nonparticipating insurance contract is a settlement of a postretirement benefit obligation rather than an investment.

367. Under some insurance contracts, the purchaser (either the plan or the employer) acquires the right to participate in the investment performance or experience of the insurance company (participating contracts). Under those contracts, if the insurance company has favorable experience, the purchaser receives dividends. For example, if the insurance company's investment return is better than anticipated, or perhaps if actual experience related to mortality or

other assumptions is favorable, the purchaser will receive dividends that reduce the cost of the contract.

368. Participating contracts have some of the characteristics of an investment. However, the employer is as fully relieved of the obligation as with a nonparticipating contract, and a separate actuarial computation ordinarily would not be performed. The Board concluded that, except as indicated in paragraphs 369, 370, and 374, it would be appropriate to treat a participating contract the same as a nonparticipating contract and to exclude the benefits covered from measures of the accumulated postretirement benefit obligation.

369. The Board was concerned that a participating contract could be structured in such a way that the premium would be significantly in excess of the cost of nonparticipating contracts because of the expectation of future dividends. If the full amount of the premium were recognized as service cost in the year paid and dividends were recognized as return on plan assets when received, the resulting measures of postretirement benefit cost would be unrelated to benefits earned by employees. If the employer had the ability to influence the timing of dividends, it would then be possible to shift cost among periods without regard to underlying economic events. The Board concluded that part of a participating contract (the participation right) is in substance an investment that should be recognized as an asset.

370. The Board concluded that, consistent with the measurement of other assets, the participation right should be measured at fair value in periods subsequent to its acquisition to the extent that fair value can be reasonably determined. The Board recognizes, however, that some participating contracts may not provide a basis for a better estimate of fair value than that provided by amortized cost and concluded that, in that situation, amortized cost should be used. That conclusion is not intended to permit use of amortized cost if that amount is in excess of net realizable value.

371. When it addressed employers' accounting for pensions, the Board was advised that the information needed to treat insurance contracts purchased from an insurance company affiliated with the employer as investments (that is, to include those contracts and covered benefits in plan assets and the accumulated postretirement benefit obligation, respectively) was not available and would not be cost beneficial to develop. The Board expects that also to be true for postretirement benefits. Therefore, this Statement requires only contracts purchased from a captive insurance subsidiary, and contracts purchased from an insurance company when there is reasonable doubt whether the insurance company will meet its obligations under the contract, to be treated as investments. However, because an employer remains indirectly at risk if insurance contracts are purchased from an affiliate, the Board concluded that disclosure of the approximate amount of annual benefits covered by those contracts should be required.

Insurance Contracts Used in Settlements

372. As discussed in paragraph 368, an employer is as fully relieved of the accumulated

postretirement benefit obligation by the purchase of a participating contract as it is by the purchase of a nonparticipating contract. Consequently, except as discussed in paragraphs 369 and 374, the Board concluded that it would be appropriate to treat a participating contract the same as a nonparticipating contract and to consider purchases of participating contracts as settlements of accumulated postretirement benefit obligations.

373. The Board recognizes that it is difficult to determine the extent to which a participating contract exposes the purchaser to the risk of unfavorable experience, which would be reflected in lower than expected future dividends or failure to recover the cost of the participation right. The Board also recognizes that under some insurance contracts described as participating, the purchaser might remain subject to all or most of the same risks and rewards of future experience that would have existed had the contract not been purchased. The Board also is aware that some participating contracts may require or permit payment of additional premiums if experience is unfavorable. The Board concluded that if a participating contract requires or permits payment of additional premiums because of experience losses, or if the substance of the contract is such that the purchaser retains all or most of the related risks and rewards, the purchase of that contract does not constitute a settlement.

374. If the purchase of a participating contract constitutes a settlement for purposes of this Statement, recognition of a previously unrecognized net gain or loss is required (paragraphs 93 and 94) except for settlement of a small portion of the accumulated postretirement benefit obligation (paragraph 95). However, the possibility of a subsequent loss is not completely eliminated with a participating contract because realization of the participation right is not assured. Because of the continuing risk of the participation right, this Statement requires that the maximum gain subject to recognition from a settlement (paragraph 94) be reduced by an amount equal to the cost of the participation right before determining the full or pro rata portion of that maximum gain (paragraph 93) to be recognized.

Multiemployer Plans

375. Generally, the employers that participate in multiemployer postretirement benefit plans are similar, in terms of both nature and industry affiliation, to employers that participate in multiemployer pension plans. Although the plans provide defined benefits, they typically require a defined contribution from participating employers. Consequently, an employer's obligation to a multiemployer plan may be changed by events affecting other participating employers and their employees.

376. At present in the United States, the consequences of an employer's withdrawal from a multiemployer postretirement benefit plan are different from an employer's withdrawal from a multiemployer pension plan. In addition to any contractual requirements, withdrawal from a multiemployer pension plan is governed by the Multiemployer Pension Plan Amendments Act of 1980. An employer withdrawing from a multiemployer postretirement benefit plan is currently only subject to any contractual requirements.

377. In a multiemployer setting, eligibility for benefits is defined by the plan; retired employees continue to receive benefits whether or not their former employers continue to contribute to the plan. On the other hand, plan participants not yet eligible for benefits may lose accumulated postretirement benefits if their current or former employer withdraws from a plan unless they take or have a job with other employers who participate in the plan. While the plan may have the option of cancelling the accrued service credits that apply toward the required service, within the bargaining unit, of plan participants who were employed by a withdrawing employer and who become or are employed by another participating employer, that rarely occurs because of the difficulty of matching employees to specific employers. For example, in certain industries, an employee may work for more than one employer in a single day and different employers on different days, making it difficult to associate any portion of that employee's past service with a specific employer.

378. The Board considered the substantive differences between a multiemployer plan and a single-employer plan and concluded that separate disclosure for the two types of plans would enhance the understandability and usefulness of the information. This Statement requires disclosures that provide descriptive information about multiemployer plans and the cost recognized for the period. In some situations, employers participating in a multiemployer plan that provides health and welfare benefits to active employees and retirees may be unable to distinguish the portion of their required contribution that is attributable to postretirement benefits. In those situations, the amount of the aggregate contribution to the general health and welfare benefit plan is to be disclosed. The Board also noted that the provisions of FASB Statement No. 5, *Accounting for Contingencies,* apply when additional liabilities, such as a withdrawal liability or increased contribution pursuant to a plan's "maintenance of benefits" clause, are probable and should be recognized, or are reasonably possible and, therefore, should be disclosed.

Multiple-Employer Plans

379. Some plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance more like aggregations of single-employer plans than like multiemployer plans. In a multiple-employer plan, the plan terms are defined by each participating employer. Whereas an employer's obligation to a multiemployer plan may be changed by events affecting other participating employers and their employees, an employer's accumulated postretirement benefit obligation in a multiple-employer plan is unchanged by those events. Therefore, the Board concluded that for purposes of this Statement, multiple-employer plans should be considered single-employer plans rather than multiemployer plans and each employer's accounting should be based on its respective interest in the plan.

Postretirement Benefit Plans outside the United States

380. The Board understands that employer-provided postretirement benefits currently are not prevalent outside the United States. In countries where those plans are provided, the Board believes that this Statement should be applied. The Board is not aware of extraordinary

problems arising from the application of Statement 87 to foreign plans, and those requirements are based on actuarial calculations and assumptions similar to those needed to apply this Statement. Therefore, the provisions of this Statement are equally applicable to postretirement benefit plans in the United States and in other countries.

381. The Board concluded, however, that practical problems could arise in communicating the requirements of and obtaining the information necessary for initial application of this Statement to plans outside the United States. The Board concluded that allowing an extra two years before application is required would give employers time to make necessary arrangements in an orderly manner and would reduce the cost of transition. Unless the accumulated postretirement benefit obligation of the plans outside the United States is significant relative to the accumulated postretirement benefit obligation for all of an employer's postretirement benefit plans, the Board concluded that disclosures for those plans could be combined with disclosures for plans in the United States.

Defined Contribution Plans

382. The Board concluded that in most cases the formula in a defined contribution plan unambiguously assigns contributions to periods of employee service. The employer's present obligation under the terms of the plan is fully satisfied when the contribution for the period is made, provided that costs (defined contributions) are not being deferred and recognized in periods after the related service period of the individual to whose account the contributions are to be made. The Board concluded that defined contribution plans are sufficiently different from defined benefit plans that disclosures about the two types of plans should not be combined. The disclosures about defined contribution plans required by this Statement are limited to a description of the plan, the basis for determining contributions, the nature and effect of significant matters affecting comparability of information presented, and the cost recognized during the period.

Business Combinations

383. Opinion 16 requires that, in a business combination accounted for as a purchase, an acquiring company allocate the cost of an acquired company to the assets acquired and the obligations assumed. Paragraph 88 of that Opinion sets forth general guides for assigning amounts to the individual assets acquired and liabilities assumed, and includes in that list liabilities and accruals, such as deferred compensation, measured at the present value of the amounts to be paid determined at appropriate current interest rates. Practice has been mixed, with most acquiring companies assigning no value to those postretirement benefit obligations.

384. This Statement amends Opinion 16 to clarify that, in a business combination accounted for as a purchase, the purchaser recognize a postretirement benefit obligation (asset) for any assumed accumulated postretirement benefit obligation in excess of (less than) plan assets. That obligation (asset) is to be measured using the assumptions that reflect the purchaser's assessment of relevant future events. The terms of the substantive plan as determined by the purchaser may

differ from the acquired company's plan if the criteria set forth in paragraph 24 for defining the substantive plan that is the basis of the accounting are satisfied. The Board concluded that those criteria apply equally in establishing an obligation that is assumed and an obligation that arises from the exchange of benefits for employee service.

385. Improvements to the acquired company's plan that are attributed to employee service prior to the date the business combination is consummated and that are conditions of the purchase agreement are not to be accounted for as prior service cost, but as part of the purchase agreement. Other improvements to the plan that are not part of the purchase agreement are to be accounted for as prior service cost to the extent they are attributable to employees' prior service pursuant to this Statement. If it is expected that the plan will be terminated or curtailed, the effects of those actions should be reflected in measuring the accumulated postretirement benefit obligation.

386. The Board concluded that measurement of the unfunded or overfunded accumulated postretirement benefit obligation defined by this Statement generally is consistent with measurement of a pension benefit obligation (or asset) assumed in a business combination accounted for as a purchase pursuant to paragraph 88 of Opinion 16, as amended by paragraph 75 of Statement 87. One result of the accounting required by this Statement is that the effects of plan amendments and gains and losses of the acquired company's plan that occurred before the acquisition are not a part of future postretirement benefit cost of the acquiring company. That is consistent with purchase accounting as defined by Opinion 16, which specifies that a new basis of accounting reflect the bargained (fair) value of assets acquired and liabilities assumed whether or not those values were previously reflected in the acquired company's financial statements.

387. The Board concluded that no recognition of additional liabilities for multiemployer plans should be required under Opinion 16 unless conditions exist that make an additional liability probable. The Board was not convinced that there ordinarily is an obligation for future contributions to a multiemployer plan or that recognition of any contractual withdrawal liability would provide useful information about such an obligation, absent a probable withdrawal.

Effective Dates

388. The Exposure Draft proposed that this Statement generally be effective for fiscal years beginning after December 15, 1991. Most respondents urged the Board to delay the proposed effective date for at least one year because of their concerns about the availability and reliability of data necessary to measure employers' postretirement benefit obligations and cost. Other respondents noted the significant improvement to financial statements resulting from adoption of the accounting required by this Statement and suggested accelerating the effective date.

389. The Board decided to allow more than the normal amount of time between issuance of this Statement and its required application to give employers and their advisors time to assimilate the requirements and to obtain the information required. The Board concluded that an additional

one-year delay in the general effective date to fiscal years beginning after December 15, 1992, is adequate for those purposes. As noted previously, the Board also allowed an additional two years before employers are required to apply the provisions of this Statement to plans outside the United States and before certain small employers are required to apply those provisions. Paragraph 267 discusses the effective date for the amendment of Opinion 12.

Appendix B: COMPARISON OF EMPLOYERS' ACCOUNTING FOR OTHER POSTRETIREMENT BENEFITS WITH EMPLOYERS' ACCOUNTING FOR PENSIONS

390. This appendix provides a summary comparison of the major provisions of this Statement with the provisions of FASB Statement No. 87, *Employers' Accounting for Pensions.*

	Other Postretirement Benefit Plan	Non-pay-related Pension Plan
Basis for accounting	Extant written plan unless (a) past practice of maintaining a consistent level of cost sharing or consistently increasing or decreasing the cost-sharing provisions of the plan, (b) communication of intended changes to cost-sharing policy,* or (c) past practice of regular increases in monetary benefits indicates substantive plan differs from extant written plan; substantive plan is basis for accounting	Extant written plan unless a past practice of regular increases in non-pay-related benefits or benefits under career-average-pay plan indicates substantive commitment differs from extant written plan, then substantive commitment is basis for accounting
Attribution method and period	Benefit/years-of-service approach that attributes expected benefit obligation (EBO)† for postretirement benefits to years of service to date employee attains full eligibility for benefits expected to be provided to employee; beginning of attribution period is employee's date of hire unless plan only grants credit for service from a later date, in which case benefits are generally attributed from beginning of that credited service period;equal amount of EBO attributed to each year of service in attribution period	Benefit/years-of-service approach that attributes EBO to years of service in accordance with plan benefit formula If plan benefit formula results in disproportionate attribution to later years of service, equal amount of EBO attributed to years of service to date employee attains full eligibility for those benefits

Recognition of net cost

Service cost	Actuarial present value (APV) of EBO allocated to a period of employee service during attribution period	Same as for other postretirement benefits
Interest cost	Accrual of interest, to reflect effects of passage of time on the accumulated benefit obligation ‡	Same as for other postretirement benefits
Actual return on plan assets	Actual return based on fair value (FV) of plan assets at beginning and end of period, adjusted for contributions and benefit payments	Same as for other postretirement benefits
Prior service cost	Plan initiations and amendments treated as retroactive except for plan initiations that specifically provide new benefits only in exchange for future service	Retroactive benefits defined by plan initiation or amendment
Measurement	Change in ABO for new or amended benefits granted to plan participants	Same as for other postretirement benefits
Amortization	Delayed; equal amount assigned to each future year of service to full eligibility date of each active plan participant	Delayed; equal amount assigned to each future year of service of each active plan participant
	Presumption of economic benefit in future years; can overcome presumption if evidence that *increasing* plan benefits has no future economic benefit for the employer	Same as for other postretirement benefits
	If all or almost all participants are fully eligible for benefits, their remaining life expectancy used, rather than future service period	If all or almost all participants are inactive, their remaining life expectancy used, rather than remaining service period

	Alternative approaches permitted that more rapidly reduce unrecognized cost	Same as for other postretirement benefits
Negative plan amendment	Immediate recognition of effect precluded; initially offsets existing unrecognized prior service cost and unrecognized transition obligation, balance is amortized	Same treatment as pension benefit increase
Gains and losses	Changes in ABO and plan assets from experience different from that assumed or from changes in assumptions	Same as for other postretirement benefits
	Gain-loss component of net cost consists of (a) differences between actual and expected return on plan assets, (b) amortization of unrecognized net gain or loss, and (c) amount immediately recognized as a gain or loss due to decision to temporarily deviate from substantive plan; asset gains/losses not reflected in market-related value (MRV)§ required to be amortized	Except for (c), same as for other postretirement benefits
Recognition	Either immediate or delayed; if immediate, gains (losses) that do not offset previously recognized losses (gains) first reduce any unrecognized transition obligation (asset)	Either immediate (without offsetting any unrecognized transition obligation or asset) or delayed
Minimum amortization	Unrecognized net gain or loss in excess of 10 percent of greater of ABO or MRV of plan assets, amortized over average remaining service period of active plan participants	Same as for other postretirement benefits
	If all or almost all participants are inactive, amortized over their average remaining life expectancy rather than over remaining service period	Same as for other postretirement benefits

Definition of plan assets	Assets segregated and restricted for sole purpose of providing the defined benefit	Same as for other postretirement benefits
Recognition of minimum liability	Recognition of minimum liability not required	ABO (for all plan participants) in excess of FV of plan assets If additional liability recognized, contra amount recognized first as intangible asset up to amount of unrecognized prior service cost and unrecognized transition obligation, with any excess reported as reduction of equity
Business combinations	Measure obligation assumed as unfunded ABO for all plan participants, using purchaser's assumptions	Same as for other postretirement benefits
Transition		
Measurement	Over- or underfunded *ABO for all plan participants*	*Same as for other postretirement benefits*
Recognition	Either immediate or delayed	Delayed recognition required
	If immediate, amount attributable to plan initiation or benefit improvements adopted after December 21, 1990 treated as unrecognized prior service cost and amount attributable to purchase business combinations consummated after December 21, 1990 treated as retroactive adjustment of purchase price allocation	Immediate recognition precluded
	If delayed, amortized on straight-line basis over average remaining service period of active plan participants; cannot be less rapid than pay-as-you-go cost	Amortized on a straight-line basis over average remaining service period of active plan participants
	If amortization period determined above is less than 20 years, may use a 20-year period	If amortization period determined above is less than 15 years, may use a 15-year period

	If all or almost all participants are inactive, their average remaining life expectancy used	*Same as for other postretirement benefits*
Disclosure	Similar to disclosures required by Statement 87, supplemented by disclosure of descriptive information about the substantive plan, amortization of transition obligation or asset, assumed health care cost trend rate, and the effect on the measure of the ABO and aggregate of service and interest cost components of net periodic cost of a one-percentage-point increase in the health care cost trend rate, holding all other assumptions constant	Disclosures required by Statement 87
	Disclosures for plans in and outside the United States may be combined unless ABO for plans outside the United States is significant relative to aggregate ABO	Disclosures for plans in and outside the United States may not be combined unless those plans use similar economic assumptions

Note: This appendix compares employers' accounting for a *postretirement benefit plan* with employers' accounting for a *non-pay-related pension plan* because most postretirement benefit plans (in particular, postretirement health care plans) do not have benefit formulas that are pay related.

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* Conditions (a) and (b) are subject to the criteria in paragraph 25.

† *Expected benefit obligation (EBO)*—actuarial present value (APV) as of a particular date of postretirement benefits expected to be paid to or for a current plan participant.

‡ *Accumulated benefit obligation (ABO)*—the portion of EBO attributed to service rendered to a specified date. That portion for a pension plan with a benefit formula that is pay related is referred to as the *projected benefit obligation*. However, for a pension plan with a benefit formula that excludes the effects of future compensation levels, the accumulated benefit obligation is the appropriate measure of the pension obligation for comparative purposes throughout this appendix.

§ *Market-related value (MRV)*—either fair market value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years.

Appendix C

ILLUSTRATIONS

CONTENTS

Appendix C: ILLUSTRATIONS

Introduction

391. This appendix provides additional discussion and examples that illustrate the application of certain requirements of this Statement to specific aspects of employers' accounting for postretirement benefits other than pensions. The illustrations are referenced to the applicable paragraph(s) of the standards section of this Statement where appropriate. Certain illustrations have been included to facilitate the understanding and application of certain provisions of this Statement that apply in specific circumstances that may not be encountered frequently by employers. The fact patterns shown may not be representative of actual situations but are presented only to illustrate those requirements.

392. Throughout these illustrations the accumulated postretirement benefit obligation and service cost are assumed as inputs rather than calculated based on some underlying population. For simplicity, benefit payments are assumed to be made at the end of the year, service cost is assumed to include interest on the portion of the expected postretirement benefit obligation attributed to the current year, and interest cost is based on the accumulated postretirement benefit obligation as of the beginning of the year. For unfunded plans, benefits are assumed to be paid directly by the employer and are reflected as a reduction in the accrued postretirement benefit cost. The required disclosure of the reconciliation of the funded status of the plan is illustrated in many of the cases; however, for simplicity, the components of the accumulated postretirement benefit obligation are not included in those reconciliations as required by paragraph 74(c)(2). In many of the cases, application of the underlying concepts has been simplified by focusing on a single employee for purposes of illustration. In practice, the determination of the full eligibility date and the measurement of postretirement benefit cost and obligation are based on employee groups and consider various possible retirement dates and the probabilities associated with retirement at each of those dates.

Illustration 1—Illustration of Terms

Case 1A—Expected Postretirement Benefit Obligation and Accumulated Postretirement Benefit Obligation

393. This Statement uses two terms to describe certain measures of the obligation to provide postretirement benefits: ***expected postretirement benefit obligation and accumulated postretirement benefit obligation.*** The expected postretirement benefit obligation for an employee is the actuarial present value as of a measurement date of the postretirement benefits expected to be paid to or for the employee, the employee's beneficiaries, and any covered

dependents. Prior to the date on which an employee attains full eligibility for the benefits that employee is expected to earn under the terms of the postretirement benefit plan (the full eligibility date), the accumulated postretirement benefit obligation for an employee is a portion of the expected postretirement benefit obligation. On and after the full eligibility date, the accumulated postretirement benefit obligation and the expected postretirement benefit obligation for an employee are the same. (Refer to paragraphs 20 and 21.) The following example illustrates the notion of the expected postretirement benefit obligation and the relationship between that obligation and the accumulated postretirement benefit obligation at various dates.

394. Company A's plan provides postretirement health care benefits to all employees who render at least 10 years of service and attain age 55 while in service. A 50-year-old employee, hired January 1, 1973 at age 30 and eligible for benefits upon attaining age 55, is expected to terminate employment at age 62 and is expected to live to age 77. A discount rate of 8 percent is assumed.

At December 31, 1992, Company A estimates the expected amount and timing of benefit payments for that employee as follows:

	Expected	Present Value at Age		
Age	Future Claims	50	53	55
63	$ 2,796	$1,028	$1,295	$1,511
64	3,093	1,052	1,326	1,547
65	856	270	339	396
66	947	276	348	406
67	1,051	284	357	417
68	1,161	291	366	427
69	1,282	297	374	436
70	1,425	306	385	449
71	1,577	313	394	460
72	1,744	321	404	471
73	1,934	329	415	484
74	2,137	337	424	495
75	2,367	346	435	508
76	2,620	354	446	520
77	3,899	488	615	717
	$28,889	$6,292	$7,923	$9,244

395. The expected and accumulated postretirement benefit obligations at December 31, 1992 (age 50) are $6,292 and $5,034 (20/25 of $6,292), respectively. An equal amount of the expected postretirement benefit obligation is attributed to each year of service from the

employee's date of hire to the employee's full eligibility date (age 55) (paragraphs 43 and 44). Therefore, when the employee is age 50, the accumulated postretirement benefit obligation is measured as 20/25 of the expected postretirement benefit obligation, as the employee has rendered 20 years of the 25-year credited service period. Refer to Case 1B (paragraphs 397-408) for additional illustrations on the full eligibility date and Case 1C (paragraphs 409-412) for additional illustrations on attribution.

396. Assuming no changes in health care costs or other circumstances, the accumulated postretirement benefit obligation at December 31, 1995 (age 53) is $7,289 (23/25 of $7,923). At the end of the employee's 25th year of service and thereafter, the expected postretirement benefit obligation and the accumulated postretirement benefit obligation are equal. In this example, at December 31, 1997, when the employee is 55 and fully eligible for benefits, the accumulated and expected postretirement benefit obligations are $9,244. At the end of the 26th year of service (December 31, 1998) when the employee is 56, those obligations are $9,984 ($9,244 plus interest at 8 percent for 1 year).

Case 1B—Full Eligibility Date

397. The *full eligibility date* (paragraph 21) is the date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee under the terms of the postretirement benefit plan. Therefore, the present value of all of the benefits expected to be received by or on behalf of an employee is attributed to the employee's credited service period, which ends at the full eligibility date. Determination of an employee's full eligibility date is affected by plan terms that provide incremental benefits expected to be received by the employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by an employee's current dependency status or by plan terms that define when benefit payments commence. The following examples (paragraphs 398-408) are presented to assist in understanding the full eligibility date.

Plans That Provide Incremental Benefits for Additional Years of Service

Graded benefit formula

398. Some plans have benefit formulas that define different benefits for different years of service. To illustrate, assume a plan in which the percentage of postretirement health care coverage to be provided by an employer is defined by groups of years of service. The plan provides 20 percent postretirement health care coverage for 10 years of service after age 35, 50 percent for 20 years of service after age 35, 70 percent for 25 years of service after age 35, and 100 percent for 30 years of service after age 35. The full eligibility date for an employee who was hired at age 35 and is expected to retire at age 62 is at age 60. At that date the employee has rendered 25 years of service after age 35 and is eligible to receive a benefit of 70 percent health care coverage after retirement. The employee receives no additional benefits for the last two years of service.

Pay-related plans

399. Some plans may base the amount of benefits or level of benefit coverage on employees' compensation, for example, as a percentage of their final pay. To the extent the plan's postretirement benefit formula defines benefits wholly or partially as a function of future compensation (that is, the plan provides incremental benefits for additional years of service when it is assumed that final pay will increase), determination of the full eligibility date for an employee is affected by those additional years of service the employee is expected to render (paragraph 21). In addition, measurements of the postretirement benefit obligation and service cost reflect the best estimate of employees' future compensation levels (paragraph 33).

400. For example, assume a plan provides life insurance benefits to employees who render 20 years of service and attain age 55 while in service; the benefit is equal to 20 percent of final pay. A 55-year-old employee, who currently earns a salary of $90,000, has worked 22 years for the company. The employee is expected to retire at age 60 and is expected to be earning $120,000 at that time. The employee is eligible for life insurance coverage under the plan at age 55, when the employee has met the age and service requirements. However, because the employee's salary continues to increase each year, the employee is not *fully eligible* for benefits until age 60 when the employee retires because the employee earns an incremental benefit for each additional year of service beyond age 55. That is, the employee earns an additional benefit equal to 20 percent of the increase in salary each year from age 55 to retirement at age 60 for service during each of those years.

Spousal coverage

401. Some postretirement benefit plans provide spousal or dependent coverage or both if the employee works a specified number of years beyond the date at which the employee attains eligibility for single coverage. For example, a postretirement health care plan provides single coverage to employees who work 10 years and attain age 50 while in service; the plan provides coverage for dependents if the employee works 20 years and attains age 60 while in service. Because the additional 10 years of service may provide an incremental benefit to employees, for employees expected to satisfy the age and service requirements and to have covered dependents during the period following the employee's retirement, their full eligibility date is the date at which they have both rendered 20 years of service and attained age 60 while in service. For employees not expected to have covered dependents after their retirement or who are not expected to render at least 20 years of service or attain age 60 while in service, or both, their full eligibility date is the date at which they have both rendered 10 years of service and attained age 50 while in service.

Single Plan Provides Health Care and Life Insurance Benefits

402. Some postretirement benefit plans may have different eligibility requirements for different

types of benefits. For example, assume a plan provides a postretirement death benefit of $100,000 to employees who render 20 or more years of service. Fifty percent health care coverage is provided to eligible employees who render 10 years of service, 70 percent coverage to those who render 20 years of service, and 100 percent coverage to those who render 30 years of service. Employees are eligible for the health care and death benefits if they attain age 55 while in service.

403. The full eligibility date for an individual hired at age 30 and expected to terminate employment at age 62 is the date on which that employee has rendered 30 years of service and attained age 55 while in service (age 60 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 100 percent health care coverage). The full eligibility date for an employee hired at age 37 and expected to retire at age 62 is the date on which that employee has rendered 20 years of service and attained age 55 while in service (age 57 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 70 percent health care coverage).

Plans That Provide Benefits Based on Status at Date of Termination

404. Some postretirement benefit plans provide coverage for the spouse to whom an employee is married when the employee terminates service; that is, the marital status of an employee upon termination of employment determines whether single or spousal coverage is to be provided. In measuring the expected postretirement benefit obligation, consideration is given to factors such as when benefit coverage will commence, who will receive benefits (employee and any covered dependents), and the expected need for and utilization of benefit coverage. However, determination of an employee's full eligibility date is not affected by plan terms that define when payments commence or by an employee's current marital (or dependent) status (paragraph 21).

405. For example, assume a plan provides postretirement health care coverage to employees who render at least 10 years of service and attain age 55 while in service; health care coverage also is provided to employees' spouses at the date of the employees' retirement. A 55-year-old employee is single, has worked for the company for 30 years, and is expected to marry at age 59 and to retire at age 62. Although the employee is entitled to spousal coverage only if married at retirement, at age 55 the employee has earned the right to spousal coverage. The probability that the employee will be married when the employee retires is included in the actuarial assumptions developed to measure the expected postretirement benefit obligation for that plan participant. The full eligibility date (age 55 in this example) is not affected by that measurement assumption.

Postretirement Benefits to Be Received by Disabled Plan Participants

406. Some plans provide postretirement benefits to disabled employees. For example, Company B provides disability income and health care benefits to employees who become

disabled while in service and have rendered 10 or more years of service. Retiree health care benefits are provided to employees who render 20 or more years of service and attain age 55 while in service. Employees receiving disability benefits continue to accrue "credit" toward their eligibility for retiree health care benefits. Under this plan, an employee hired at age 25, who becomes permanently disabled at age 40, is entitled to receive retiree health care benefits commencing at age 55 (in addition to any disability income benefits commencing at age 40) because that employee worked for Company B for more than 10 years before becoming disabled. Under the terms of the plan the employee is given credit for working to age 55 even though no actual service is rendered by the employee after the disabling event occurs.

407. Because the employee is permanently disabled, the full eligibility date is accelerated to recognize the shorter period of service required to be rendered in exchange for the retiree health care benefits—in this case the full eligibility date is age 40, the date of the disabling event. For a similar employee who is temporarily disabled at age 40 but returns to work and attains age 55 while in service, the full eligibility date is age 55. Company B's expected postretirement benefit health care obligation for the permanently disabled employee is based on the employee's expected health care costs commencing at age 55 and is attributed ratably to that employee's active service to age 40.

408. Only some employees become and remain disabled. Therefore, in measuring the expected postretirement benefit obligation and in determining the attribution period for plan participants expected to become disabled, the probability and timing of a disabling event is considered in determining whether employees are likely to become disabled and whether they will be entitled to receive postretirement benefits.

Case 1C—Attribution

Attribution Period

409. Paragraph 44 states that the beginning of the *attribution period* shall be the date of hire unless the plan's benefit formula grants credit only for service from a later date, in which case benefits generally shall be attributed from the beginning of that credited service period. For example, for a plan that provides benefit coverage to employees who render 30 or more years of service or who render at least 10 years of service and attain age 55 while in service, without specifying when the credited service period begins, the expected postretirement benefit obligation is attributed to service from the date of hire to the earlier of the date at which a plan participant has rendered 30 years of service or has rendered 10 years of service and attained age 55 while in service. However, for a plan that provides benefit coverage to employees who render at least 20 years of service after age 35, the expected postretirement benefit obligation is attributed to a plan participant's first 20 years of service after attaining age 35 or after the date of hire, if later than age 35.

410. For a plan with a benefit formula that attributes benefits to a credited service period that is nominal in relation to employees' total years of service prior to their full eligibility dates, an

equal amount of the expected postretirement benefit obligation for an employee is attributed to each year of that employee's service from date of hire to date of full eligibility for benefits. For example, a plan with a benefit formula that defines 100 percent benefit coverage for service for the year in which employees attain age 60 has a 1-year credited service period. If plan participants are expected to have rendered an average of 20 years of service at age 60, the credited service period is nominal in relation to their total years of service prior to their full eligibility dates. In that case, the service cost is recognized from date of hire to age 60.

Attribution Pattern

411. For all plans, except those that "frontload" benefits, the expected postretirement benefit obligation is attributed ratably to each year of service in the attribution period (paragraph 43). That is, an equal amount of the expected postretirement benefit obligation is attributed to each year of service from the employee's date of hire or beginning of the credited service period, if later, to the employee's full eligibility date unless (a) the credited service period is nominal relative to the total years of service prior to the full eligibility date (paragraph 410) or (b) the benefit formula frontloads benefits (paragraph 412).

Frontloaded plans

412. Some plans may have a benefit formula that defines benefits in terms of specific periods of service to be rendered in exchange for those benefits but attributes all or a disproportionate share of the expected postretirement benefit obligation to employees' early years of service in the credited service period. An example would be a life insurance plan that provides postretirement death benefits of $250,000 for 10 years of service after age 45 and $5,000 of additional death benefits for each year of service thereafter up to age 65 (maximum benefit of $300,000). For plans that frontload the benefit, the expected postretirement benefit obligation is attributed to employee service in accordance with the plan's benefit formula (paragraph 43). In this example, the actuarial present value of a $25,000 death benefit is attributed to each of the first 10 years of service after age 45, and the actuarial present value of an additional $5,000 death benefit is attributed to each year of service thereafter up to age 65.

Case 1D—Individual Deferred Compensation Contracts

413. An employer may provide postretirement benefits to selected employees under individual contracts with specific terms determined on an individual-by-individual basis. Paragraph 13 of this Statement amends APB Opinion No. 12, *Omnibus Opinion—1967,* to attribute those benefits to the individual employee's years of service following the terms of the contract. Paragraphs 414-416 illustrate the application of paragraph 13 for individual deferred compensation contracts.

Contract Provides Only Prospective Benefits

414. A company enters into a deferred compensation contract with an employee at the date of

hire. The contract provides for a payment of $150,000 upon termination of employment following a minimum 3-year service period. The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying $150,000 by the company's return on equity for the year. Also, each year after the third year of service, interest at 10 percent per year is credited on the amount due under the contract at the beginning of that year. Accordingly, a liability of $150,000 is accrued in a systematic and rational manner over the employee's first 3 years of service. Following the third year of service, the accrued liability is adjusted annually for accrued interest and the increased or decreased compensation based on the company's return on equity for that year. At the end of the third year and each subsequent year of the employee's service, the amount accrued equals the then present value of the benefit expected to be paid in exchange for the employee's service rendered to that date.

Contract Provides Retroactive Benefits

415. A company enters into a contract with a 55-year-old employee who has worked 5 years for the company. The contract states that in exchange for past and future services and for serving as a consultant for 2 years after the employee retires, the company will pay an annual pension of $20,000 to the employee, commencing immediately upon the employee's retirement. It is expected that the future benefits to the employer from the consulting services will be minimal. Consequently, the actuarial present value of a lifetime annuity of $20,000 that begins at the employee's expected retirement date is accrued at the date the contract is entered into because the employee is fully eligible for the pension benefit at that date.

416. If the terms of the contract described in paragraph 415 had stated that the employee is entitled to the pension benefit only if the sum of the employee's age and years of service equal 70 or more at the date of retirement, the employee would be fully eligible for the pension benefit at age 60, after rendering 5 more years of service. The actuarial present value of a lifetime annuity of $20,000 that begins at the expected retirement date would be accrued in a systematic and rational manner over the 5-year period from the date the contract is entered into to the date the employee is fully eligible for the pension benefit.

Illustration 2—Delayed Recognition and Reconciliation of Funded Status

417. Pursuant to the provisions of this Statement, the recognition of certain changes affecting measurement of the accumulated postretirement benefit obligation or the fair value of plan assets may be delayed. Those changes include plan amendments (paragraph 51) and gains and losses due to experience different from that assumed or from changes in assumptions (paragraph 56). Information about the effect of the changes that have been afforded delayed recognition is provided through disclosure of the reconciliation of the funded status of a plan to the accrued or prepaid postretirement benefit cost recognized in the employer's statement of financial position (paragraph 74(c)). The following cases (2A-2E, paragraphs 418-429) show how events that change the accumulated postretirement benefit obligation are reflected in that reconciliation.

Case 2A—Unrecognized Obligation at Date of Transition

418. For an unfunded plan with an accumulated postretirement benefit obligation of $600,000 at the date of transition (January 1, 1993), the reconciliation of the funded status of the plan with the amount shown in the statement of financial position as of that date is as follows:

Accumulated postretirement benefit obligation	$(600,000)[a]
Plan assets at fair value	0
Funded status	(600,000)
Transition obligation at January 1, 1993	600,000
(Accrued)/prepaid postretirement benefit cost	$ 0

[a]The actuarial present value of the obligation for fully eligible plan participants' expected postretirement benefits and the portion of the expected postretirement benefit obligation for other active plan participants attributed to service to December 31, 1992. For example, assume a plan provides benefits to employees who render at least 20 years of service after age 35. For employees age 45 with 10 years of service at December 31, 1992, the accumulated postretirement benefit obligation is 50% of the expected postretirement benefit obligation for those employees. For employees age 55 or older who have rendered 20 or more years of service at December 31, 1992 and retirees (collectively referred to as fully eligible plan participants), the accumulated postretirement benefit obligation is the full amount of the expected postretirement benefit obligation for those employees.

419. The transition obligation or asset is the difference between (a) the accumulated postretirement benefit obligation and (b) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost at the date of transition (paragraph 110). If, as in this case, advance contributions were not made and postretirement benefit cost was not accrued in prior periods, there is no accrued or prepaid postretirement benefit cost recognized in the statement of financial position, and, therefore, the transition obligation is equal to the unfunded status ($600,000).

Unrecognized Amounts after Date of Transition

420. After the date of transition, any change in the accumulated postretirement benefit obligation or the plan assets (other than contributions and benefit payments) either is unrecognized, due to the delayed recognition provisions of this Statement, or is included in net periodic postretirement benefit cost. Contributions by the employer increase plan assets and decrease the accrued postretirement benefit cost or increase the prepaid postretirement benefit cost, subject to the provision of paragraph 112 requiring recognition of an additional amount of the unrecognized transition obligation in certain situations. All changes in the accumulated postretirement benefit obligation and plan assets are reflected in the reconciliation. Using Case 2A as the starting point, the following reconciliations (Cases 2B-2E) illustrate the effect of changes in assumptions or changes in the plan on measurement of the accumulated postretirement benefit obligation.

Case 2B—Employer Accrual of Net Periodic Postretirement Benefit Cost

421. Benefit payments of $42,000 are made at the end of 1993. Changes in accrued postretirement benefit cost, accumulated postretirement benefit obligation, and unrecognized transition obligation in 1993 are summarized as follows:

	Accrued Postretirement Benefit Cost	Accumulated Postretirement Benefit Obligation	Unrecognized Transition Obligation
Beginning of year	$ 0	$ (600,000)	$600,000
Recognition of components of net periodic postretirement benefit cost:			
Service cost	(32,000)	(32,000)	
Interest cost [a]	(48,000)	(48,000)	
Amortization of transition obligation [b]	(30,000)		(30,000)
	(110,000)	(80,000)	(30,000)
Benefit payments	42,000	42,000	
Net change	(68,000)	(38,000)	(30,000)
End of year	$(68,000)	$(638,000)	$570,000

[a]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year.

[b]The transition obligation of $600,000 is amortized on a straight-line basis over 20 years. Illustration 3, Case 3B, (paragraphs 435-442) illustrates the constraint on delayed recognition of the transition obligation pursuant to paragraph 112.

422. The funded status of the plan at January 1, 1993 and December 31, 1993 is reconciled with the amount shown in the statement of financial position at those dates as follows:

	1/1/93	Net Change	12/31/93
Accumulated postretirement benefit obligation	$(600,000)	$(38,000)	$(638,000)
Plan assets at fair value	0		0
Funded status	(600,000)	(38,000)	(638,000)
Unrecognized transition obligation	600,000	(30,000)	570,000
Accrued postretirement benefit cost	$ 0	$(68,000)	$ (68,000)

Case 2C—Plan Amendment That Increases Benefits

423. The plan is amended on January 2, 1994, resulting in a $90,000 increase in the accumulated postretirement benefit obligation. The effects of plan amendments are reflected immediately in measurement of the accumulated postretirement benefit obligation; however, the effects of the amendment are not recognized immediately in the financial statements, but rather are recognized on a delayed basis (paragraph 52).

424. Benefit payments of $39,000 are made at the end of 1994. Changes in accrued postretirement benefit cost, accumulated postretirement benefit obligation, unrecognized transition obligation, and unrecognized prior service cost in 1994 are summarized as follows:

	Accrued Postretirement Benefit Cost	Accumulated Postretirement Benefit Obligation	Unrecognized Transition Obligation	Unrecognized Prior Service Cost
Beginning of year	$ (68,000)	$(638,000)	$570,000	$ 0
Plan amendment		(90,000)		90,000
Recognition of components of net periodic postretirement cost:				
Service cost	(30,000)	(30,000)		
Interest cost [a]	(58,240)	(58,240)		
Amortization of transition obligation	(30,000)		(30,000)	
Amortization of prior service cost [b]	(9,000)			(9,000)
	(127,240)	(178,240)	(30,000)	81,000
Benefit payments	39,000	39,000		
Net change	(88,240)	(139,240)	(30,000)	81,000
End of year	$(156,240)	$(777,240)	$540,000	$81,000

[a]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year and to the increase in that obligation for the unrecognized prior service cost at the date of the plan amendment [($638,000 x 8%) + ($90,000 x 8%)].

[b]As permitted by paragraph 53, prior service cost of $90,000 is amortized on a straight-line basis over the average remaining years of service to *full eligibility* for benefits of the active plan participants (10 years in this example).

425. The funded status of the plan at December 31, 1993 and 1994 is reconciled with amount shown in the statement of financial position at those dates as follows:

	12/31/93	Net Change	12/31/94
Accumulated postretirement benefit obligation	$(638,000)	$(139,240)	$(777,240)
Plan assets at fair value	0		0
Funded status	(638,000)	(139,240)	(777,240)
Unrecognized prior service cost	0	81,000	81,000
Unrecognized transition obligation	570,000	(30,000)	540,000
Accrued postretirement benefit cost	$ (68,000)	$ (88,240)	$(156,240)

Case 2D—Negative Plan Amendment

426. The plan is amended on January 4, 1995, resulting in a $99,000 reduction in the accumulated postretirement benefit obligation. As with a plan amendment that increases benefits, the effect of a negative plan amendment (an amendment that decreases benefits) is reflected immediately in the measurement of the accumulated postretirement benefit obligation. The effects of the negative plan amendment are recognized by first reducing any existing unrecognized prior service cost and then any existing unrecognized transition obligation; the remainder is recognized in the financial statements on a delayed basis.

427. Benefit payments in 1995 are $40,000. Changes in accrued postretirement benefit cost, accumulated postretirement benefit obligation, unrecognized transition obligation, and unrecognized prior service cost in 1995 are summarized as follows:

	Accrued Postretirement Benefit Cost	Accumulated Postretirement Benefit Obligation	Unrecognized Transition Obligation	Unrecognized Prior Service Cost
Beginning of year	$(156,240)	$(777,240)	$540,000	$ 81,000
Plan amendment [a]		99,000	(18,000)	(81,000)
Recognition of components of net periodic postretirement benefit cost:				
Service cost	(30,000)	(30,000)		
Interest cost [b]	(54,259)	(54,259)		
Amortization of transition obligation [c]	(29,000)		(29,000)	
Amortization of prior service cost	0			0
	(113,259)	14,741	(47,000)	(81,000)
Benefit payments	40,000	40,000		

Net change	(73,259)	54,741	(47,000)	(81,000)
End of year	$(229,499)	$(722,499)	$493,000	$ 0

[a]Paragraph 55 requires that the effects of a plan amendment that reduces the accumulated postretirement benefit obligation be used first to reduce any existing unrecognized prior service cost, then any unrecognized transition obligation. Any remaining effects are recognized on a delayed basis over the remaining years of service to full eligibility for those plan participants who were active at the date of the amendment. If all or almost all of the plan participants were fully eligible at that date, the remaining effects should be recognized over the remaining life expectancy of those plan participants.

[b]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year and to the decrease in that obligation at the date of the plan amendment [($777,240 x 8%) - ($99,000 x 8%)].

[c]Unrecognized transition obligation of $522,000 ($540,000 - $18,000) is amortized on a straight-line basis over the 18 years remaining in the transition period.

428. The funded status of the plan at December 31, 1994 and 1995 is reconciled with the amount shown in the statement of financial position at those dates as follows:

	12/31/94	Net Change	12/31/95
Accumulated postretirement benefit obligation	$(777,240)	$ 54,741	$(722,499)
Plan assets at fair value	0		0
Funded status	(777,240)	54,741	(722,499)
Unrecognized prior service cost	81,000	(81,000)	0
Unrecognized transition obligation	540,000	(47,000)	493,000
Accrued postretirement benefit cost	$(156,240)	$(73,259)	$(229,499)

Case 2E—Change in Assumption

429. The assumed health care cost trend rates are changed at December 31, 1995, resulting in a $55,000 increase in the accumulated postretirement benefit obligation. The net loss that results from a change in the health care cost trend rates assumption is reflected immediately in the measurement of the accumulated postretirement benefit obligation. However, as with most other gains and losses, the effect of a change in assumption may be recognized in the financial statements either immediately or on a delayed basis, as long as the recognition method is applied consistently.

	Before Change	Net Loss	After Change
Accumulated postretirement benefit obligation	$(722,499)	$(55,000)	$(777,499)
Plan assets at fair value	0		0
Funded status	(722,499)	(55,000)	(777,499)
Unrecognized net loss [a]	0	55,000	55,000
Unrecognized transition obligation	493,000		493,000
Accrued postretirement benefit cost	$(229,499)	$ 0	$(229,499)

[a]This Statement generally does not require recognition of gains and losses in the period in which they arise (paragraphs 56-61). However, at a minimum, amortization of an unrecognized net gain or loss is required to be recognized as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, the unrecognized net gain or loss exceeds 10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets. Applications of those provisions are included in Illustration 5 (paragraphs 455-471).

Illustration 3—Transition—Determination of Amount and Timing of Recognition

430. This Statement provides two options for recognizing the transition obligation or asset in the statement of financial position and in the statement of income. An employer can phase in recognition of the transition obligation (asset) over future periods, as illustrated in Case 3A (paragraphs 432-434). However, phasing in recognition of a transition obligation should not result in less rapid recognition than would have resulted under pay-as-you-go accounting. That is, after the transition date, the cumulative postretirement benefit cost accrued should not be less than cumulative benefit payments (paragraph 112). Case 3B (paragraphs 435-442) illustrates a situation in which recognition of the transition obligation is accelerated as a result of that constraint.

431. Alternatively, an employer can recognize the transition obligation (asset) immediately in net income of the period of the change. However, if immediate recognition is elected, the amount attributable to the effects of a plan initiation or any benefit improvements adopted after December 21, 1990 is treated as prior service cost and excluded from the transition amount immediately recognized. In addition, an employer who chooses to immediately recognize its transition obligation shall, in accounting for any purchase business combination consummated after December 21, 1990, include in the purchase price allocation the unfunded accumulated postretirement benefit obligation assumed (paragraph 111). Case 3C (paragraphs 443-448) illustrates a situation in which those limitations apply.

Case 3A—Measuring the Transition Obligation and Delayed Recognition

432. Company C adopts this Statement for its financial statements for the year beginning January 1, 1993. Prior to adopting this Statement, Company C accrued postretirement benefit costs and made contributions to the plan to the extent those contributions were tax deductible. At January 1, 1993, the company had accrued postretirement benefit cost of $150,000 and plan assets of $180,000.

433. The transition obligation or asset is measured as the difference between (a) the accumulated postretirement benefit obligation and (b) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost as of the date of transition (paragraph 110). Company C's transition obligation is determined as follows:

Accumulated postretirement benefit obligation	$(465,000)
Plan assets at fair value	180,000
Accumulated postretirement benefit obligation in excess of plan assets	(285,000)
Accrued postretirement benefit cost	150,000
Transition obligation	$(135,000

434. Company C elects to delay recognition of its transition obligation. Paragraph 112 permits straight-line amortization of the transition obligation or asset over the average remaining service period of plan participants or 20 years, if longer. Company C estimates the average remaining service period of its active employees who are plan participants at the date of transition to be 10 years. Therefore, Company C can elect to amortize its transition obligation of $135,000 on a straight-line basis over either the average remaining service period of 10 years or 20 years. That amortization (either $13,500 for 10 years or $6,750 for 20 years) is included as a component of net periodic postretirement benefit cost. However, amortization of the transition obligation is accelerated when the constraint on delayed recognition described in paragraph 112 applies. (Refer to Case 3B, paragraphs 435-442.)

Case 3B—Constraint on Delayed Recognition of Transition Obligation

435. At December 31, 1992, the accumulated (and unrecognized) postretirement benefit obligation and plan assets of a defined benefit postretirement plan sponsored by Company D are as follows:

Accumulated postretirement benefit obligation	$(255,000)
Plan assets at fair value	0
Transition obligation	$(255,000)

436. Company D adopts this Statement for the year beginning January 1, 1993. At December 31, 1992, Company D has no prepaid or accrued postretirement benefit cost (postretirement benefit cost in prior years was accounted for on a pay-as-you-go basis). The average remaining service period of active plan participants at the date of transition is 17 years. Since the average remaining service period is less than 20 years, Company D may elect to amortize the transition obligation over 20 years rather than 17 years (paragraph 112); Company D elects the 17-year period.

437. Benefit payments in 1993 are $45,000. Changes in accrued postretirement benefit cost, accumulated postretirement benefit obligation, and unrecognized transition obligation in 1993 are summarized as follows:

	Accrued Postretirement Benefit Cost	Accumulated Postretirement Benefit Obligation	Unrecognized Transition Obligation
Beginning of year	$ 0	$(255,000)	$255,000
Recognition of components of net periodic postretirement benefit cost:			
Service cost	(30,000)	(30,000)	
Interest cost [a]	(20,400)	(20,400)	
Amortization of transition obligation [b]	(15,000)		(15,000)
	(65,400)	(50,400)	(15,000)
Benefit payments	45,000	45,000	
Net change	(20,400)	(5,400)	(15,000)
End of year	$(20,400)	$(260,400)	$240,000

[a] An 8% discount rate is assumed.

[b] $255,000 ÷ 17 years = $15,000 per year.

438. The funded status of the plan at January 1, 1993 and December 31, 1993 is reconciled with the amount shown in the statement of financial position at those dates as follows:

	1/1/93	Net Change	12/31/93
Accumulated postretirement benefit obligation	$(255,000)	$ (5,400)	$(260,400)
Plan assets at fair value	0		0
Funded status	(255,000)	(5,400)	(260,400)
Unrecognized transition obligation	255,000	(15,000)	240,000
Accrued postretirement benefit cost	$ 0	$(20,400)	$ (20,400)

439. In 1994, benefit payments increase to $95,000 and service cost increases to $35,000. Changes in accrued postretirement benefit cost, accumulated postretirement benefit obligation, and unrecognized transition obligation in 1994 are summarized as follows:

	Accrued Postretirement Benefit Cost	Accumulated Postretirement Benefit Obligation	Unrecognized Transition Obligation
Beginning of year	$(20,400)	$(260,400)	$240,000
Recognition of components of net periodic postretirement benefit cost:			
Service cost	(35,000)	(35,000)	
Interest cost	(20,832)	(20,832)	
Amortization of transition obligation [c]	(18,768)		(18,768)
	(74,600)	(55,832)	(18,768)
Benefit payments	95,000	95,000	
Net change	20,400	39,168	(18,768)
End of year	$ 0	$(221,232)	$221,232

[c]Amortization of the transition obligation in 1994 includes straight-line amortization of $15,000 plus additional recognition of $3,768. The additional recognition is required because in 1994 cumulative benefit payments subsequent to the January 1, 1993 transition date exceed cumulative postretirement benefit cost accrued subsequent to that date (paragraph 112). The additional transition obligation required to be recognized ($3,768) is determined as follows:

	1993	1994
Benefit payments:		
1/1/93 to beginning of current year		$ 45,000
Current year	$45,000	95,000
Cumulative 1/1/93 to end of current year	$45,000	$140,000
Postretirement benefit cost recognized:		
1/1/93 to beginning of current year		$ 65,400
Current year prior to recognition of any additional amount pursuant to paragraph 112	$65,400	70,832
Cumulative 1/1/93 to end of current year before applying paragraph 112 constraint	65,400	136,232
Additional amount required to be recognized pursuant to paragraph 112	0	3,768
Cumulative 1/1/93 to end of current year	$65,400	$140,000

440. The objective of the constraint on delayed recognition of the transition obligation (paragraph 112) is to preclude slower recognition of postretirement benefit cost (as a result of applying the delayed recognition provisions of this Statement) than would have resulted under pay-as-you-go accounting for costs. An indication that the constraint may apply is the existence of a prepaid postretirement benefit cost after the date of transition for an enterprise that prior to the application of this Statement was on a pay-as-you-go basis of accounting for other postretirement benefits. For example, in paragraph 439, if the employer had not recognized the additional $3,768 of transition obligation, the employer would have had a prepaid postretirement benefit cost equal to that amount.

441. The funded status of the plan at December 31, 1993 and 1994 is reconciled with the amount shown in the statement of financial position at those dates as follows:

	12/31/93	Net Change	12/31/94
Accumulated postretirement benefit obligation	$(260,400)	$ 39,168	$(221,232)
Plan assets at fair value	0		0
Funded status	(260,400)	39,168	(221,232)
Unrecognized transition obligation	240,000	(18,768)	221,232 [d]
Accrued postretirement benefit cost	$ (20,400)	$20,400	$ 0

[d]In 1995, the straight-line amortization of the unrecognized transition obligation will be $14,749 ($221,232/15 years remaining in the transition period).

442. Paragraph 113 states that if at the measurement date for the beginning of an employer's fiscal year it is expected that additional recognition of any remaining unrecognized transition obligation will be required pursuant to paragraph 112, amortization of the transition obligation for interim reporting purposes shall be based on the amount expected to be amortized for the year, except for the effects of applying the constraint in paragraph 112 for any settlement required to be accounted for pursuant to paragraphs 90-94. Those effects shall be recognized when the related settlement is recognized. The effects of changes during the year in the initial assessment of whether additional recognition of the unrecognized transition obligation will be required for the year shall be recognized over the remainder of the year. The amount of the unrecognized transition obligation to be recognized for a year shall be finally determined at the end of the year (or the measurement date, if earlier) based on the constraints on delayed recognition discussed in paragraph 112; any difference between the amortization of the transition obligation recognized during interim periods and the amount required to be recognized for the year shall be recognized immediately.

